NASCUS
National Association of State Credit Union Supervisors

April 26, 2016

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

Re: NASCUS Comments on OTR Methodology

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS), the professional association of the state credit union regulatory agencies and represents the interests of the nation's state credit union system, submits the following comments in response to the National Credit Union Administration's (NCUA's) request for comments on the methodology used to establish the Overhead Transfer Rate (OTR). NASCUS and its members have long held concerns regarding the OTR Methodology, and NCUA's management of its complex role as both the chartering authority of federal credit unions (FCUs) and as the administrator of the National Credit Union Share Insurance Fund (NCUSIF). We commend NCUA for bringing the OTR Methodology forward for formal notice and comment. After careful consideration of the issues, we submit the following comments and recommendations to help ensure the funds in the NCUSIF are managed in an equitable manner consistent with the letter, and spirit, of the Federal Credit Union Act (FCUA).[1]

During the January 21, 2016 NCUA Board meeting where the OTR Methodology was approved for public comment, the NCUA Board also voted to publish the FCU Operating Fee for public comment.[2] As has always been the case, NASCUS does not comment on proposed rules exclusively affecting FCUs. Suffice to note that our views on the allocation of expenses to the NCUSIF, and equitable treatment of federally insured state chartered credit unions (FISCUs) speak to our views of NCUA's overall budget allocations. We also reiterate, as has consistently been NASCUS' position, that we express no opinion on NCUA's overall budget expenditures. NASCUS believes that a regulatory agency is best positioned to know the resources it needs to maintain a safe and sound supervisory program.[3]

Through numerous iterations of the OTR methodology, across decades of adjustments to the actual transfer rate, dozens of letters back and forth between NASCUS and NCUA, opinion editorials in the trade press, and now thirty-three pages of exposition in the *Federal Register*, the issues presented by the OTR have often seemed beguilingly complicated. However, formulas and

[1] 12 U.S.C. Chap. 14.
[2] 81 Fed. Reg. 4674 (January 27, 2016).
[3] We note that state agency budgets are subject to oversight through budget hearings, legislative allocations, boards of oversite and state executive branch oversight among other means.

accounting audits cannot obfuscate the fact that the questions presented are not complicated at all: ***How should the costs of NCUA's operations be distributed? Should the benefits of efficiencies created by NCUA's unique dual role accrue to the NCUSIF or to the NCUA as a chartering authority?***

It is self-evident that Congress never intended the share insurance fund to completely subsidize NCUA's Title I chartering responsibilities. Congress intended the NCUSIF to benefit from NCUA's Title I responsibilities, not the other way around.

This issue is important to NASCUS, to state regulators (alternately state supervisory authorities or SSAs), and to state credit unions because NCUA expenses improperly allocated to the NCUSIF artificially inflate the cost of credit union share insurance, threaten the dual chartering system by artificially disadvantaging the state system, and inhibit regulatory and supervisory innovation. Fundamentally, NCUA's current methodology that classifies all safety and soundness as solely an insurance fund concern runs contrary to both the plain language of the FCUA and the history of bank and credit union regulation in the United States.

In our comments that follow, NASCUS will demonstrate:

- NCUA's proposition that it has no safety and soundness examination obligations as a chartering authority is without support in statute or practice;
- NCUA's current OTR methodology threatens the dual chartering system;
- NCUA's unique role as both competing chartering authority and Administrator of the NCUSIF obligates it to treat FISCUs equitably;
- NCUA's three "independent" reviews of the OTR Methodology have been flawed;
- The OTR Methodology is subject to the Administrative Procedure Act (APA);
- NCUA's OTR Methodology is flawed even when accepting NCUA's classification of Insurance Fund responsibilities;
- The determination of the OTR must not be delegated to staff; and
- There are more equitable ways to allocate NCUA's operating costs consistent with Congress' intent.

<u>As the Chartering Agency of Federal Credit Unions, NCUA has Safety and Soundness Examination Obligations Pursuant to Title I of the Federal Credit Union Act</u>

NCUA's entire OTR Methodology is premised on the idea that the NCUA, created in 1970 to charter and supervise FCUs, has absolutely no safety and soundness responsibilities for the entities it charters. According to NCUA's reasoning, the only reason it examines FCUs for safety and soundness is to protect the NCUSIF. Put another way, NCUA feels no obligation, as a federal agency empowered to grant credit union charters, to ensure those charters are safe and sound for the members entrusting the FCU with their savings. In a similar vein, NCUA's methodology means NCUA as a federal agency empowered to charter financial intuitions, feels no obligation to ensure their safe and sound operation for the protection of the U.S. financial system. That a chartering authority would hold such beliefs, abdicating its responsibilities solely to the deposit insurer is a remarkable proposition. It is also unsupported by the FCUA, nor is it supported by a simple examination of the actions and missions of other regulators. Suffice to say, no other federal or state banking regulator shares NCUA's view of the division of duties between prudential supervision and share/deposit insurance supervision. It is curious that NCUA's notice for comment quotes from the mission statements of its sister federal banking regulators in a footnote, because those mission statements, as well as NCUA's own characterization of the historic role of the "regulator" as opposed to the "insurer" completely and unequivocally contradict NCUA's entire OTR Methodology premise. It is worth examining this opening portion of NCUA's preamble for its *Federal Register* notice in detail:

> There is a distinct overlap between the historical role of a regulator, concerned with enforcing laws and implementing public policy, and that of an insurer. Though not motivated by the associated financial liability that comes with the role of insurer, regulators address ***threats to the viability of their financial institutions*** to protect consumers and their jurisdiction's economy. ***This focus on viability benefits the insurer***. The primary roles of an insurer are to protect depositors and the taxpayer, and contribute to the stability of the financial system. Before the advent of federal deposit insurance, federal financial institution regulators were concerned with protecting the stability of the financial system by ''regulating'' it. Thus, financial institution examinations focused on ensuring (1) statutes and regulations were followed to protect consumers, and (2) ***institutions were viable to protect consumer deposits, preserve access to financial services, and safeguard the stability of the economy***.
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> - Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4814 (January 27, 2016). (emphasis added)(NCUA's *Federal Register* Notice)
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Examining to protect against "threats to the viability" of the financial institution ***is examining for safety and soundness***. Contrary to the NCUA's fundamental premise that all safety and soundness is insurance, the FCUA states that "regulators" (as in NCUA as chartering authority) are responsible for safety and soundness to protect the public and the economy. That is why the chartering authority for National Banks, the Office of the Comptroller of the Currency (OCC), examines national banks for safety and soundness. And yet, the OCC has no role as insurer of bank deposits. Neither does the Federal Reserve Board (FRB), yet it examines state chartered member banks for safety and soundness. And lest one be confused by NCUA's reference to "historic roles" pre-deposit insurance, a review of the current mission statements of the OCC and FRB confirm that remains the case today, despite the fact that the Federal Deposit Insurance Corporation (FDIC) has been in existence since 1933.[4]

The OCC lists its mission statement as "To ensure that national banks and federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations."[5] For its part, the FRB "has

[4] Pub. L 73-66, 48 Stat. 162 (June 16, 1933).
[5] Available on the OCC website at http://www.occ.gov/about/what-we-do/mission/index-about.html.

primary supervisory authority for state banks that elect to become members of the Federal Reserve System (state member banks)."[6] The FRB defines this supervisory authority as "the monitoring, inspecting, and examining of banking organizations to assess their condition and their compliance with relevant laws and regulations…"[7] For 80 years, two federal banking regulators have performed safety and soundness supervision in the banking sector despite the existence of a deposit insurer.[8]

In order for the NCUA to justifiably ignore this long-standing precedent and paradigm evident at other federal banking agencies, one would expect a clear mandate or at the very least clear support in statute. There is no such support. In fact, a plain reading of the FCUA leads to the opposite conclusion.

NCUA's *Federal Register* notice, contains only a brief discussion of the statutory justification for allocating all safety and soundness expenses to the NCUSIF. That NCUA's legal justification for its extreme interpretation of the FCUA is afforded less than one page in its 33-page request for comments is disappointing given that NCUA's entire methodology turns on the legal question of NCUA's Title I obligations as a chartering authority.

NCUA's entire legal justification for the OTR Methodology is as follows:

> NCUA has a unique dual role in that it serves as both the regulator of FCUs and the insurer of FCUs and FISCUs. Given this dual role, it is appropriate to allocate examination and supervision costs between the NCUSIF and Operating Fees charged to FCUs. The policy rationale for this allocation is supported by various provisions of the FCU Act. In Title II of the FCU Act, Congress established the NCUSIF and housed it within NCUA for administration by the NCUA Board.
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> Congress envisioned efficiencies from this arrangement, as well as NCUA's partnership with state regulators. Evidence of intent to streamline can be found in 12 U.S.C. 1782(a)(5), which requires reports FCUs must file under Title I of the FCU Act to be prepared so ''that they can be used for share insurance purposes.'' Similarly, this provision requires NCUA to use the reports filed by FISCUs with their state regulators ''for share insurance purposes . . . [t]o the maximum extent feasible. . . .''
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> Congress also recognized that, in addition to losses related to credit union failures, the NCUSIF would incur expenses related to its administration, including examination staff and other employees. Title II empowers the NCUA Board to determine the proper allocation of ''administrative and other expenses incurred'' under Title II that may be funded by direct requisitions from the NCUSIF. Title II further subjects the resources expended for ''insurance purposes'' to the Board's discretion by empowering the Board to ''appoint examiners who shall have power, on its behalf, to examine any insured credit union, any credit union making application for insurance of its member accounts, or any

[6] Available on the FRB website at http://www.federalreserve.gov/pf/pdf/pf_5.pdf.
[7] Available at the FRB website http://www.federalreserve.gov/pf/pdf/pf_5.pdf.
[8] The FDIC was established in 1933. The OCC predates the FDIC and the FRB was established in 1935.

> closed insured credit union whenever in the judgment of the Board an examination is necessary to determine the condition of any such credit union. . . .'' Title I confirms this design by requiring that salaries and expenses of the Board and NCUA employees ''be paid from fees and assessments (including income earned on insurance deposits) levied on insured credit unions under [the FCU Act].'' In addition to assessments charged to all insured credit unions simply by nature of their NCUSIF insurance, Title I requires an annual Operating Fee charged to FCUs in recognition of the additional duties required of NCUA under Title I with respect to FCUs.
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> NCUA also has the authority to promulgate rules and regulations to carry out the provisions of Title II. Accordingly, the NCUA Board has approved rules and regulations that specifically address safety and soundness and protect the NCUSIF. Under the discretion vested in it under the FCU Act, the NCUA Board's primary motivation for the agency's regulations and examination program has been managing risk to the NCUSIF posed by all insured credit unions, whether state chartered or federal. The Board notes that NCUA's role as insurer is best fulfilled by a proactive approach to preventing losses, in addition to paying the post-failure obligations that NCUSIF insurance coverage requires. Since the implementation of federal share insurance in 1970, the NCUA Board has instituted a much more proactive examination and supervision program geared toward safety and soundness, which focuses on insurance related issues. In 2002, the NCUA Board strengthened its commitment to fulfilling NCUA's role as insurer by implementing the Risk-Focused Examination Program. This program bases examination scope and timing to a large extent on the risks an institution poses to the NCUSIF. The OTR's portion of NCUA's Operating Budget, including its changes over time, reflects the Board's fulfillment of its insurance responsibilities under the FCU Act under evolving economic and legislative circumstances.
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> \- NCUA's *Federal Register* notice[9]

NCUA begins its legal analysis by noting that Congress gave it authority over FCUs as a chartering agency and authority over FISCUs and FCUs as an insurer. No one disputes this. It is NCUA's supervisory obligations in those roles that are in dispute, and how Congress intended NCUA to carry out its dual missions.

Next, NCUA acknowledges that Congress envisioned the combined structure of NCUA to provide cost-saving efficiencies.[10] However, Congress intended the efficiencies to accrue to the benefit of the NCUSIF, not solely to NCUA as a chartering authority. NCUA cites the controlling provision, noting that the FCUA directs NCUA to structure its Title I examinations so they may be used by the NCUSIF.[11] This is also exactly what Congress had in mind for reliance on state exams, instructing the NCUSIF to rely on state exams to the maximum extent feasible.[12] In order to reduce the NCUSIF's expenses, and

[9] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4806 (January 27, 2016).
[10] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4806 (January 27, 2016).
[11] 12 U.S.C. 1783.
[12] 12 U.S.C. 1782(a)(5).

achieve these efficiencies, Congress directed the NCUSIF to use the examinations produced by others: in this case NCUA as chartering authority, and the states. The FCUA literally can be read no other way.

NCUA then notes that Title II, its insurance role, allows it to have examiners, to conduct exams, and to pay expenses related to its insurance mission. NCUA then also notes that Title I requires it to assess an operating fee for what NCUA calls "additional duties." It is important to note that the term "additional duties" is NCUA's construct, it is not the wording used in the statute.

In fact, Title I does contain very explicit instructions for NCUA. At this point it is worth noting that Title I safety and soundness supervisory responsibilities predate NCUA's NCUSIF administration by 36 years.[13] In fact, Title I, the chartering supervisory provisions unrelated to the NCUSIF, expressly call for FCUs to be under the supervision of the NCUA Board, make financial reports as required by NCUA, and be subject to examination by the Board.[14] If NCUA as a chartering authority is only concerned with consumer protection, why did Congress require FCUs to submit financial reports to NCUA as their chartering authority? Congress grants separate and distinct authority under Title II for the NCUSIF to obtain reports it might deem necessary for NCUSIF purposes. The two important points are that Congress envisioned NCUA supervising the financial conditions of their federal charters under Title I and created an affirmative obligation for FCUs to submit those reports under Title I. The second point is that the Title II authority is ***discretionary*** for the NCUSIF: it may command additional reports ***if it needs them***.

NCUA claims discretion to determine how to allocate costs however it sees fit. Generally speaking, it is true agencies are given broad deference to interpret their statutes.[15] However, this is not the case if Congress speaks to a matter in the statute. In this instance Congress clearly spoke to how NCUA should manage its funding. Therefore, there is no ambiguity as to how NCUA was to allocate costs, and NCUA is not free to interpret the FCUA as it sees fit.[16]

In order to carry out its Title I, non-NCUSIF duties, Congress instructed NCUA to charge an annual operating fee to be, in the wording of 12 U.S.C. 1755(d) of the FCUA, "expended by the Board to defray the expenses incurred in carrying out the provisions of this Act, including the examination and supervision of Federal Credit Unions." Congress is instructing NCUA to supervise the credit unions it charters, including their financial condition, and to charge an annual operating fee, all pursuant to Title I. And, Congress went further.

As NCUA notes in its discussion excerpted above, Congress instructed that "The salaries and expenses of the Board and employees…shall be paid from fees and assessments (including income earned on insurance deposits) levied on insured credit unions under this Act."[17] This provision, cited approvingly by NCUA, means exactly the opposite of what NCUA believes. Rather than a carte blanche to allocate all of its Title I safety and soundness obligations to the

[13] The FCUA was first promulgated in 1934. The NCUSIF was not created until 1970.
[14] 12 U.S.C. 1756.
[15] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984),
[16] *King v. Burwell*, 576 U.S. ___ (2015); and *Michigan v. Environmental Protection Agency*, 576 U.S. ___ (2015)
[17] 12 U.S.C. 1766(j)(3).

NCUSIF, Congress included the NCUSIF as a ***subordinate, not primary,*** source of funding. As NASCUS explained in a legal study we commissioned and provided NCUA in 2001:

> This provision deserves careful scrutiny. While directing the NCUA Board to use operating fees and assessments to pay for agency costs, it also opens the door for NCUA to allocate some costs to the NCUSIF. By stating that salaries and expenses must be paid for from fees and assessments, including the earnings on the NCUSIF, ***it is clear that such earnings may be used only to supplement what is collected from operating fees.*** According to *Webster's Dictionary*, to "include" means "to place, list or rate as a part or component of a whole or of a larger group, class or aggregate; to take in, enfold or comprise as a discrete or subordinate part or item of a larger aggregate group or principle." Thus, something that is "included" is not distinct, but is added on to a larger, existing group. Congress could have stated that salaries and expenses should be borne exclusively or significantly through the earnings on the NCUSIF, but it did not. Rather, it established a system under which earnings on the NCUSIF could be included or added to operating fees to cover agency costs.
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> \- 2001 NASCUS Legal Study[18]

Congress did more than limit NCUA's discretion in Title I. Congress reiterated those constraints in Title II as well. While Congress granted NCUA authority to allocate NCUSIF costs to the insurance fund, it limited the NCUSIF's expenses only to Title II activities. The FCUA limits expenditures to "administrative and other expenses incurred in carrying out the purposes ***of this title*** as it may determine to be proper."[19] We have already established NCUA has safety and soundness supervisory obligations under Title I of the FCUA. This provision in Title II prohibits NCUA from shifting the cost of those Title I safety and soundness obligations to the NCUSIF.

Ultimately, NCUA's interpretation of the FCUA, and its methodology, that the NCUSIF shoulders the full cost of NCUA's safety and soundness examinations begs a simple question: ***What exactly is the NCUSIF using from NCUA's Title I examinations?*** If the answer to that question is nothing, and NCUA's methodology says nothing, then the entire OTR stands in conflict with the FCUA.

Congress intended the NCUA to balance its roles as a chartering supervisor and an insurer. It divided NCUA's roles between Title I, its chartering supervisory functions, and Title II, its administration of the NCUSIF. As a chartering authority, NCUA has the responsibility to examine its charters for safe and sound financial condition just as the OCC, the FRB, and state regulators do. As administrator of the NCUSIF, NCUA has an obligation to review the financial condition of its insured credit unions. In so doing, we agree NCUA, on behalf the NCUSIF, would conduct some examinations of FCUs and FISCUs. However, to the "maximum extent

[18] Overhead Transfer: The Authority of the National Credit Union Administration to Allocate Costs to the National Credit Union Share Insurance Fund, CUNA Legal Department, Commissioned by NASCUS (October 2, 2001) page 19. Available at http://nascus.org/OTRresources/NASCUSLegalStudyofOverheadTransfer.pdf.

[19] 12 U.S.C. 1783(a).

feasible" the NCUSIF should be relying on exams conducted by the chartering authorities. This was a deliberate act by Congress to preserve the resources of the NCUSIF.

Background: Dual Chartering and the Foundation of the Nation's Banking System

Distinct from other countries, the banking system in the United States is a dual banking system, predicated upon the principle that a financial institution's owners may choose a state or federal charter. The dual system has resulted in the United States possessing the most innovative, resilient, and vibrant, financial services system in the world.

Dual chartering creates regulatory and supervisory diversity. Twenty-five years ago, the United States Department of the Treasury acknowledged the importance of regulatory diversity, writing that it "increases the chances that innovative approaches to policy problems will emerge…A sole regulator, not subject to challenge from other agencies, might tend to become entrenched, conservative, and shortsighted."[20] The Conference of State Bank Supervisors notes in their recent white paper on bank supervision that "For more than 150 years, the United States has gone to great lengths to promote the uniquely American dual banking system.." and that it promotes financial diversity and dynamism.[21] What is true for the banking system is also true for the credit union system.

The dual chartering system thrives on the ability of credit unions to choose a state or federal charter, and in some cases, federal or alternative insurance. Generally independent and autonomous chartering systems allow for differing supervisory views, in turn fostering innovation in regulation, efficiency in examination, and market discipline in controlling the cost of supervision. Two systems, evolving in parallel and challenging the presumptions of the other, is the healthy consequence of the credit union dual chartering system.[22]

The dual chartering system works because of the cooperative tension between charters. However, NCUA's current OTR Methodology undermines that system and weakens the credit union movement. By shifting all of its supervisory functions to the NCUSIF, NCUA minimizes the opportunity for innovation. Rather than benefit from vibrant differences between charters, the system risks homogenization.

In addition to weakening the dual chartering system, NCUA's methodology raises concerns about a possible conflict of interest within the agency in its role as both a charterer, and administrator of the NCUSIF with authority over FISCUs. In 1991, the General Accounting Office (GAO) stated "if the NCUSIF remains within the NCUA, we believe a clearer distinction between the chartering, regulatory and supervisory functions ***and the insurance function***

[20] U.S. Department of the Treasury, Modernizing the Financial System, February 1991, page XIX-6.
[21] The Public Benefit of State Financial Services Regulation, The Conference of State Bank Supervisors (January 2015). Available at https://www.csbs.org/news/csbswhitepapers/Documents/The%20Public%20Benefit%20of%20State%20Financial%20Services%20Regulation.pdf.
[22] Caught in a Regulatory Vise: The Peculiar Problem Faced by Federally Insured State-Chartered Credit Unions, Lawrence J. White, p. 7, (2001).

[emphasis added] needs to be made. Separate positions for a Director of Supervision and a Director of Insurance should be established, each reporting separately to the Board."[23] The context for the GAO report was the Congressional dissatisfaction with another combined chartering and insuring regulator in the thrift industry. Those functions were separated in 1989 because:

> At the regulatory level, critics have observed a blatant **conflict of interest** between the FHLBB and the FSLIC. [emphasis added] A high priority of the FHLBB was the survival of the thrift industry. A high priority of the FSLIC was the survival of the FSLIC, which often required the speedy closing of ailing thrifts to reduce damages. The fact that Board members of the FHLBB are also required to be directors of FSLIC created a **fundamental conflict of interest**. FHLBB members, in effect **wore two hats, guardian of the thrift industry as well as guardian of the public trust.**[emphasis added][24]

At that time GAO was asked to review NCUA's structure, and recommend internal divisions within NCUA. Of interesting note, one of the factors driving concerns about possible internal division of the NCUA was a fear that the Title I supervisor would be slow to act on one of its charters which could hurt the NCUSIF. Of course, if the Title I supervisory has no safety and soundness concerns, as asserted by NCUA, this would never have been a Congressional concern.

The Overhead Transfer Rate Methodology is Subject to the Administrative Procedures Act

NCUA is required to provide an opportunity for notice and comment for its rulemakings[25] unless otherwise exempted.[26] The OTR is subject to the APA notice and comment requirements. As noted in the Schwartz & Ballen LLP legal analysis, the OTR and the methodology used by the NCUA Board to calculate the OTR is an NCUA Board statement of general applicability and future effect designed to implement and interpret the FCUA provisions pertaining to the OTR.[27] Additionally, we do not believe the OTR qualifies for any of the exemptions from notice and comment rulemaking provided for under the APA.[28]

The OTR apportioned to FISCUs, through the NCUSIF assessment, is a significant percentage (33.6% or $93.9 million) of NCUA's total budgeted costs for 2015.[29] While it should be noted that federal credit unions (FCUs) also pay a significant portion of NCUA's costs through the OTR, increases in the OTR over the years have substantially reduced FCU operating fees due to

[23] *Credit Unions: Reforms for Ensuring Future Soundness*; General Accounting Office Report to Congress, July 1991, p.194.
[24] See Congress, regulators, RAP, and the savings and loan debacle, (regulatory accounting principles), Ahmad W. Salam, The CPA Journal on Line, (January 1994).
[25] Under the APA, a rulemaking is defined as "an agency process for formulating, amending or repealing a rule, (5 U.S.C § 551(5).
[26] 5 U.S.C. § 553.
[27] *Legal Analysis of the Administrative Procedure Used By The National Credit Union Administration To Adopt The Overhead Transfer Rate (Report to the National Association of State Credit Union Supervisors)*, Schwartz & Ballen, LLP, page 16 (June 2015).
[28] *Id.* at page 17.
[29] *Id*.

the fact that NCUA's budget costs have been shifted from FCUs to the NCUSIF-- which is funded by all federally insured credit unions.[30] This results in a competitive disadvantage for FISCUs, adversely impacted by recent changes to the OTR methodology. FISCUs have absorbed an increased percentage of NCUA expenses following the change in methodology, while FCUs enjoyed a substantial reduction in their "out of pocket" operating fees.[31]

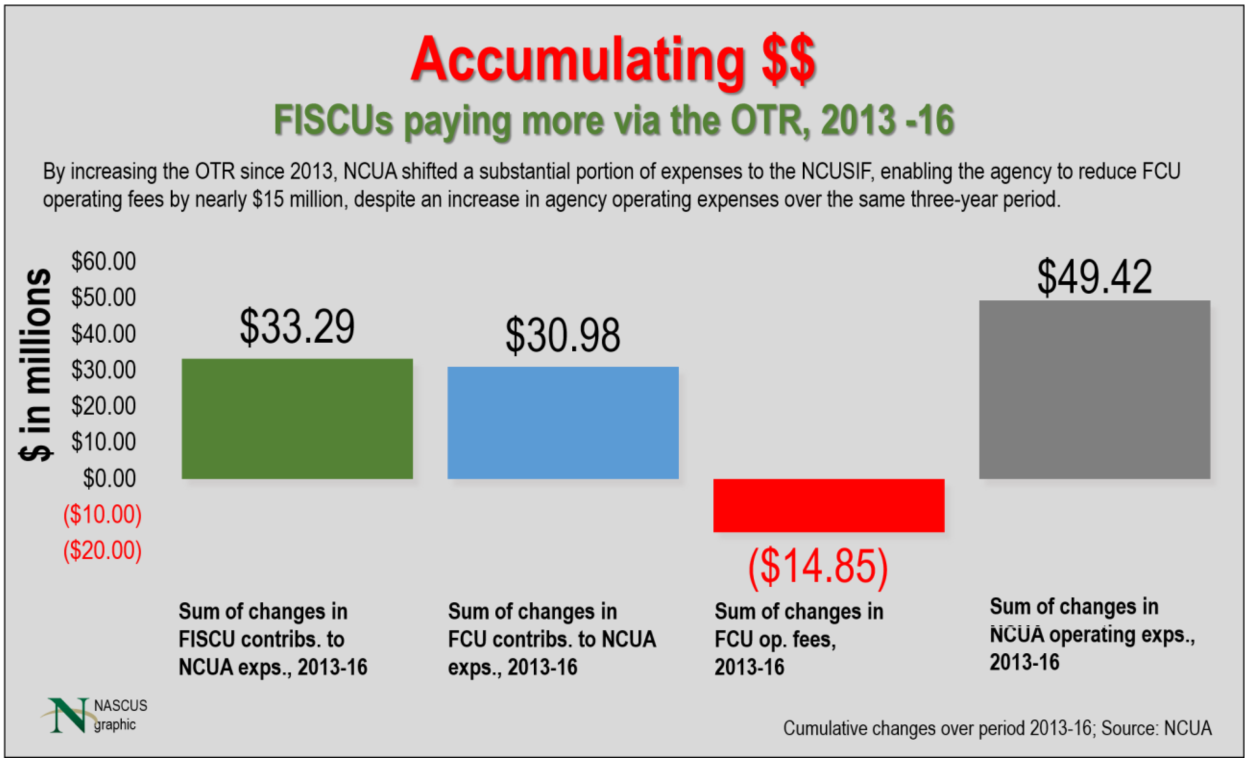
OTR Rate History (1986-2016)

Year	OTR
1986-2000	50%
2001	66.7%
2002	62%
2003	62%
2004	59.8%
2005	57.0%
2006	57.0%
2007	53.3%
2008	52.0%
2009	53.8%
2010	57.2%
2011	58.9%
2012	59.3%
2013	59.1%
2014	69.2%
2015	71.8%
2016	73.1%

Impact on Expenses Borne by FISCUs & FCUs

	FISCU OTR Contribution to NCUA Expenses	FCU OTR Contribution to NCUA Expenses	FCU Operating Fees (Actual Out-of-Pocket Expenses)	NCUA Operating Expenses
2013	$67.0m	$79.0m	$93.1m	$241.8m
2014	$85.6m	$100.1m	$82.6m	$268.3m
2015	$93.9m	$106.8m	$78.8m	$279.5m
2016	$101.5m	$111.3	$78.1m	$290.9m
Δ 2013 -2016	+$33.29m	+$30.98m	-$14.85m	+$49.42m

[30] *Id.* at page 18.
[31] *Id.*



Taking into consideration the OTR's impact on FICUs and the adverse effect on the competitive position of FISCUs in relation to FCUs, the OTR (and its methodology) should be recognized as a legislative or substantive rule subject to notice and comment to provide FICUs an opportunity to contribute input into a process that fundamentally impacts them.[32] Case law has held that where an agency's rule has "substantially and directly" impacted the "substantive rights of persons" outside of that agency, the rule would not be considered an interpretative rule or general statement of policy under the APA and would not be entitled to exemption from notice and comment requirements.[33] NCUA's OGC argued in its August 2015 letter to NASCUS CEO, Lucy Ito, that courts have "rejected" the substantial impact test when deciding if a rule should be considered legislative as opposed to interpretative.[34] On the contrary, more recent case law suggests that courts have not outright rejected the substantial impact test but have tempered it such that substantial impact alone would not be a determining factor as to whether or not a rule is legislative or interpretative. However, substantial impact related to an agency's rule can be considered along with a number of other factors to determine if a rule has been properly exempted from notice and comment requirements.[35] Taken together, the substantial impact of the OTR, the inequity of treatment of charters, the conflict of interest within NCUA in setting the OTR and stakeholder interest in ensuring an adequately funded NCUSIF, the threshold for application of APA standards is met.

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[32] *Id.* at page 18 and 19.
[33] *Anderson v. Butz*, 428 F. Supp. 245, 249 (E.D. Cal. 1975).
[34] *National Credit Union Administration's Office of General Counsel's Letter Re: Legal Analysis of Overhead Transfer Rate*, page 11 (August 18, 2015).
[35] *Cabais v. Eggers*, 690 F. 2nd 234, 237 (D.C. Cir. 1982)

The OTR, and the resulting Operating Fee result in cost allocation determinations that are binding on federally insured credit unions. That the OTR binds third parties means that it is not an internal NCUA matter or policy, but rather a rulemaking subject to notice and comment.[36]

For a complete discussion of the applicability of the APA to the OTR Methodology, we have included the Schwartz and Ballen Legal Study in its entirety in Appendix A with this letter.

As Administrator of the National Credit Union Share Insurance Fund NCUA has an Obligation to Treat Federally Insured State Chartered Credit Unions Equitably

Section 1790 of the FCUA strictly prohibits NCUA from using Title II to discriminate against FISCUs. It reads:

> Nondiscriminatory provision.—It is not the purpose of this subchapter to discriminate in any manner against State-chartered credit unions and in favor of Federal credit unions, but it is the purpose of this subchapter to provide all credit unions with the same opportunity to obtain and enjoy the benefits of this subchapter.
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> - 12 U.S.C. 1790

NCUA has been directed by Congress to ensure it does not disadvantage FISCUs in its administration of the NCUSIF. However, the OTR Methodology does just that. It takes monies from the NCUSIF to subsidize its Title I obligations. This require FISCUs to nearly fully subsidize NCUA's chartering functions. Congress understood the potential for this outcome and strictly forbade it.

It is true that in a mutual system such as the credit union share insurance system, from time to time one class of credit unions may require an inordinate amount of attention from the NCUSIF. In these natural cycles, a localized economic downturn may result in disproportionate distribution of expenses. However, such a "natural" event, which ultimately ends with a normalizing correction, is far different than premeditated shifting of expenses represented by NCUA'S OTR Methodology.

NCUA's Current Overhead Transfer Rate Methodology is Flawed on its Face

Even were one inclined to accept the proposition that all FCU safety and soundness supervision is the purview of the deposit insurer alone, and not that of the chartering authority and prudential regulator,[37] NCUA's methodology is flawed on its face. For example, NCUA asserts that because corporate credit unions do not serve consumers, one hundred percent of the Office of

[36] *Elec. Privacy Info. Cir.*, 653 F.3d (DC Cir. 2011).
[37] And NASCUS does not.

National Examination and Supervision (ONES) examination and supervision time is allocated to the NCUSIF.[38] However, corporate credit unions are obligated to comply with both the Bank Secrecy Act (BSA) and the Office of Foreign Asset Control (OFAC).[39] And yet NCUA's own classification establishes that the BSA/OFAC ***is not*** a safety and soundness regulation.[40] Presumably, ONES examines corporate credit unions for BSA/OFAC compliance, but NCUA allocates those expenses to the NCUSIF in spite of the fact its own methodology indicates those are FCU chartering costs. It would seem odd if ONES did not examine for BSA/OFAC compliance, given that BSA has been included in NCUA's supervisory priorities for the past two years.[41] Of course, ONES is also responsible for the natural person credit unions with over $10 billion in assets. Those natural person credit unions also have BSA/OFAC compliance obligations as well as consumer protection compliance obligations. If the ONES is 100 percent safety and soundness, as NCUA asserts, it is unclear from NCUA's classification of its examination hours which office, if any, within NCUA supervises those obligations for the largest natural person credit union.

A similar inherent contradiction seems to exist when comparing how NCUA classifies the work of its Office of Consumer Protection (OCP) and its Office of Small Credit Union Initiatives (OSCUI).[42] Discussing OCP, NCUA notes that one division alone in that office spends nearly 90 percent of its time reviewing FOM questions, of which only 25 percent is time spent on safety and soundness analysis.[43] Overall, only 1 percent of the OCP time is spent on safety and soundness issues and hence allocated to the NCUSIF.[44] However, when discussing the OSCUI, NCUA appears to take a far more liberal interpretation of the nexus between FOM and safety and soundness. Without explanation, NCUA asserts that 100 percent of OSCUI work on FOM expansion is insurance related and allocated to the NCUSIF.[45] There is no explanation of how many hours of OSCUI's time is spent on this, nor any explanation as to why FOM is insurance related for OSCUI, but not so much for OCP. This insurance classification with regard to OSCUI also appears to run contrary to NCUA's own methodology definition of "Non-Insurance Related Examination Procedures" which it defines as "examination or supervision contact procedures that address compliance with the laws and regulations that NCUA enforces" and includes "[c]ompliance with consumer protection laws, NCUA Rules and Regulations, the FCU Act, and Bylaws."[46] Field of membership is clearly a chartering/bylaws/compliance issue far more than

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[38] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4816 (January 27, 2016).
[39] See 31 U.S.C 5311-5330; § 748.2; See also "Bank Secrecy Act (BSA) Compliance," Corporate Credit Union Guidance Letter No. 2004-02 (June 2004). Available at https://www.ncua.gov/Resources/Documents/LCCU/LCCU2004-02.pdf.
[40] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4807 (January 27, 2016).
[41] See "Supervisory Priorities for 2016," NCUA Letter to Credit Unions No. 16-CU-01 (January 2016). Available at https://www.ncua.gov/regulation-supervision/Pages/policy-compliance/communications/letters-to-credit-unions/2016/01.aspx. See also "Supervisory Priorities for 2015," NCUA Letter to Credit Unions 15-CU-01 (January 2015). Available at https://www.ncua.gov/regulation-supervision/Pages/policy-compliance/communications/letters-to-credit-unions/2015/01.aspx.
[42] Comparing the classification of NCUA's OCP and OSCUI requires a degree of supposition because the public notice lacks detailed breakouts for these offices.
[43] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4814 (January 27, 2016).
[44] Id.
[45] Id at 4815.
[46] Id at 4807.

any safety and soundness issue. In fact, on page 4813 of NCUA's *Federal Register* notice, NCUA states that 100 percent of examiner time dedicated to OCP for such analysis is non-insurance related, again conflicting with the tables presented in the public notice.

<u>Additional Flaws in NCUA's OTR Methodology</u>

There are additional flaws in NCUA's methodology. After weighting and statistical analysis of its examination time surveys, NCUA "reverse-engineers" the OTR from its pre-determined overall operating budget.

The key element of this part of the OTR Methodology is NCUA's use of the "SSA Imputed Value" and the percentage of FCU and FISCU insured shares. After calculating the total cost of providing share insurance based on its mapping of regulations and its time surveys, NCUA adds in the costs savings of state regulator work and manipulates the data based on percentage of insured FCU and FISCU shares.[47] Both steps are problematic.

NCUA's methodology adds back into its actually budgeted expenses the "SSA Imputed Value" in order "to determine the total cost to the federally insured credit union system of providing NCUSIF insurance."[48] In 2011, PriceWaterhouseCoopers referred to this as the system-wide cost of share insurance.[49] Yet NCUA never convincingly explains why this ***should*** be factored into NCUA's expenses.

The purpose of the OTR Methodology is to determine what percentage of NCUA's annual budget is actually spent on administering the NCUSIF. While statistical arguments may be made regarding the factoring of system-wide costs, the fact remains that in this respect, the calculations are straightforward. NCUA needs to allocate a specific sum of money for the work done in administering the NCUSIF. NCUA also relies on state regulators whose work saves NCUA a calculated amount of money. Factoring in the "SSA Imputed Value" only to back it out later serves only to convolute the methodology. As discussed in detail later in these comments, NCUA should transfer the value of state regulator work directly to FISCUs or allocate it as an expense and pay it directly for the benefit of the state agencies.

PriceWaterhouseCoopers' validation notwithstanding, NCUA's allocation of share insurance costs between the state and federal systems based on percentage of insured shares is also flawed. NCUA presumes that FISCUs are responsible for 47 percent of its NCUSIF administration costs because FISCUs hold 47 percent of insured shares.[50] NCUA asserts that this presumption is fair because it is "is consistent with the mutual nature of the insurance provided by the NCUSIF, and the statutory allocation method for any NCUSIF premiums and dividends."[51] We disagree. NCUA conflates the mutual nature of the credit union system in terms of individual credit unions, and the measurable differences between the state and federal parts of that system. By

[47] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4818 (January 27, 2016).
[48] Id.
[49] Overhead Transfer Rate Review, PriceWaterhouseCoopers (January 20, 2011) page 18.
[50] Id.
[51] Id.

relying on insured shares, NCUA overstates the size of the state system, and therefore over-allocates its costs to supervise the state system.

Out of Balance[52]

NCUA does not examine insured shares. It examines insured credit unions. While the size of a credit union determines a base of exam hours needed, the fact remains that NCUA, like any regulator, must budget for the number of "units" among which those shares are distributed. Put simply, it generally costs more to examine three, $100 million asset credit unions than it does to examine a single $300 million credit union. And the federal system is far larger, by number of credit unions, than the state system.

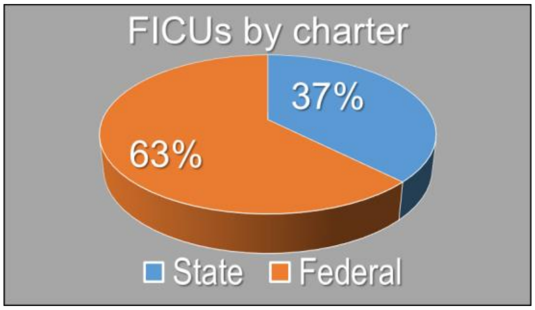

Figure 1: Comparison of of state-chartered, federally insured CUs to FCUs

As of December, 2015, there were 3,764 FCUs and only 2,257 FISCUs. While holding47 percent of insured shares. FISCUs only make up 37 percent (in numbers) of the credit union system, while FCUs make up 63 percent of the credit union system. That FCUs outnumber FISCUs by 1,507 credit unions must mean that NCUA spends measurably more on FCU safety and soundness than the insured share percentages would suggest.

Now of course, assets matter in that larger credit unions take more time to examine, sometimes substantially more, than more modest-sized credit unions. However, even by this metric it would seem that FCUs command substantially more NCUA safety and soundness time than FISCUs. Three of the five largest credit unions are FCUs, as are five of the top ten, and 28 of the top 50. In fact the six largest FCUs have nearly one-third of the combined $331 billion assets of the top 50 credit unions.[53]

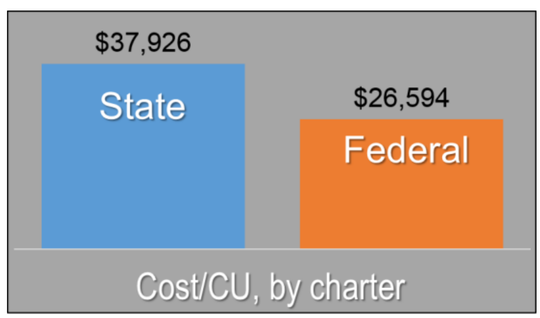

Figure 2: Cost, according to NCUA, per credit union (by charter) to examine and supervise.

The point of the OTR Methodology is to determine, by the best metric, how NCUA should allocate its expenses. It has nothing to do with mutuality, and everything to do with costs. The use of percentage of insured shares, rather than actual projected costs of supervision, obscures the entire point of the exercise. An example of the cognitive dissonance this result produces is demonstrated by the fact that in

[52] NASCUS does not suggest that insured shared equates with total assets. However, as a benchmark for examination supervision, assets has always been held as a benchmark. We note that NCUA's rules do not distinguish among credit unions by insured shares, but rather by assets.

[53] Top 50 Credit Unions by Assets, Credit Union Access, available at http://creditunionaccess.com/top50creditunions.htm.

2014, FISCUs contributed approximately $85.6 million to the OTR while FCUs contributed only $100.1 million to the OTR despite there being 1,508 ***more*** FCUs than FISCUs.[54] Put another way, the additional 1,507 FCUs only cost NCUA $9,622 per credit union to examine and supervise. In other words, NCUA is asserting that in 2014 it cost the NCUSIF $26,594 per FCU, but somehow $37,926 per FISCU. And this is with imputing value to SSA work! This makes little sense.

2014 Costs to NCUSIF of Supervising & Examining FICUs			
	Amount Contributed to OTR (in $ millions)	# of CUs	Cost per CU to Supervise & Examine
FCUs	$100.1	3,764	$26,594
FISCUs	$85.6	2,257	$37,926
Difference	$14.5	1,507	$9,622

This discrepancy might be understandable if all the very largest credit unions were FISCUs requiring more exam time. They are not. Or if there were inordinately more troubled FISCUs than FCUs. There are not. According to NCUA's *Federal Register* notice on the OTR Methodology there were 83 CAMEL code 4 FISCUs in 2014 and no CAMEL Code 5 FISCUs.[55] There is no corresponding table for FCUs. However in February, 2015, the NCUSIF reported a total of 276 CAMEL Code 4 and 5 credit unions.[56] That seems to indicate 193 CAMEL 4 or 5 FCUs. Finally, if FISCUs failed at a greater pace than FCUs, higher NCUA exam costs could be explained. However, again the record does not bear this out. To date in 2016, 4 credit unions have been liquidated, 2 FISCUs and 2 FCUs. In 2015, of the 10 credit unions liquidated, 8 were FCUs.

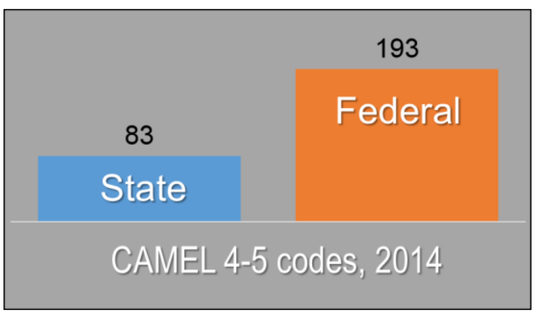

Figure 3: Comparison of CAMEL 4-5 CUs at state, federals, 2014

Clearly, NCUA's methodology of allocating costs to FISCUs based on insured shares, without adjusting for the number of credit unions skews the OTR to the disadvantage of the state system. Taken together with the other shortcomings we discuss, the only reasonable conclusion is that the OTR Methodology is deeply flawed. At a minimum, NCUA should work with state regulators to develop a more equitable, and a more sound, methodology for allocating examination hours between chartering/prudential regulator and NCUSIF administration.

[54] Source: NCUA Board estimates for 2014 as reported in Board Action Memorandum, dated November 20, 2013, from Office of Examination and Insurance to NCUA Board Re: Overhead Transfer Rate 2014.
[55] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4819 (January 27, 2016).
[56] NCUSIF 4th Quarter Statistics December 2014. Published February 18, 2015, available at https://www.ncua.gov/About/Documents/Agenda%20Items/AG20150219Item3a.pdf.

<u>The Various Reviews of the Overhead Transfer Rate Methodology Conducted over the Years Lacked a Legal Analysis</u>

Since 2001, NCUA has retained outside accounting firms to conduct three reviews of its OTR Methodology.[57] However, none of these reviews is on point because none of these reviews addressed the legal question of how Congress intended the NCUSIF's funds to be used.[58] These reports are accounting reviews, and the heart of this issue is a legal question: What are NCUA's Title I responsibilities pursuant to the FCUA? To this critical discussion, Deloitte and Touche and PriceWaterhouseCoopers add nothing.

For its part, Deloitte and Touche stated unequivocally in 2001 that it makes "no representation regarding the sufficiency of the procedures [used by NCUA]" and notes that they "were not engaged to, and did not perform an audit, the subject of which would have been the expression of an opinion on the specified elements…"[59]

Likewise, PriceWaterhouseCoopers stated in its report that it "did not state an opinion related to any issue that may be perceived with regard to NCUA's dual role as regulator and insurer, oversight or lack thereof NCUA's budget, or an interpretation of Congressional intent behind Title II of the Federal Credit Union Act…"[60]

As already discussed, the intent of Congress in seeking efficiencies for the ***NCUSIF*** by having it rely on NCUA Title I, FCU operating expense funded, safety and soundness exam ***is the issue***. Short of that, the various studies of NCUA methodology serve merely to assess whether NCUA is collecting the data properly. Of that we had little doubt.

<u>The Authority to Set the OTR Must Not be Delegated to NCUA Staff</u>

During its November 19, 2015 board meeting, the NCUA Board voted to approve a delegation to the NCUA Office of Examination and Insurance the authority to administer the methodology to calculate the Overhead Transfer Rate.[61] This was a mistake.

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[57] Deloitte & Touche in 2001; PriceWaterhouseCoopers in 2011 and 2013.
[58] Indeed, as much was publicly noted by NCUA Board Member Mark McWatters who stated during the November 19, 2015 NCUA board meeting that "The determination of the OTR methodology is essentially a legal construct and requires the sophisticated analysis of statutes, regulations, and case law, which lies beyond the operational mandate of accounting firms, even highly regarded, top-tier firms." See Board Member J. Mark McWatters Statement on Continuing Concerns with NCUA's Budget and Budget Process, November 19, 2015. Available at https://www.ncua.gov/newsroom/Pages/budget-statement-mcwatters-nov-2015.aspx.
[59] Deloitte & Touche report to NCUA (December 2001) page 1. Available at https://www.ncua.gov/About/Documents/Budget/Misc%20Documents/2001DeloitteReportonOTRProcess.pdf.
[60] PriceWaterhouseCoopers report to NCUA (January 20, 2011) page 1. Available at https://www.ncua.gov/About/Documents/Budget/Misc%20Documents/2011PwCOTRReview.pdf.
[61] See NCUA Board Action Bulletin: https://www.ncua.gov/About/Pages/board-actions/bulletins/2015/november/BAB20151119.aspx.

The NCUA Board's delegation of its final approval of the OTR to staff is an abdication of one of the most important functions of the Board: oversight of the agency's and the NCUSIF's budget. Without discussion and oversight of the actual OTR by the NCUA Board, there is no check, or accountability, for the equitable nature of the transfer. The OTR is important. The credit union system deserves better than for the leadership of the NCUSIF to delegate away important responsibility of budgetary oversight.

<u>Alternative Approaches to more Equitably Recognize the Costs of Examination</u>

1) **The NCUSIF should treat federal credit unions, and federal credit union examinations, in the exact same manner as it treats federally insured state chartered credit unions and federally insured state chartered credit union examinations**

As explained above, NCUA has safety and soundness responsibilities for federal credit unions as the chartering entity pursuant to Title I of the FCUA. Consistent with Congress' intentions and the wording of the FCUA, NCUA should internally segregate the functions of its chartering supervision of FCUs from its share insurance supervisory functions. In this way, NCUA's cost allocations would be clear: FCUs would pay an operating fee to support NCUA's supervision, including safety and soundness, and NCUA would transfer from the NCUSIF the costs of overseeing the share insurance supervision of both FCUSs and FISCUs.

Put another way, under this approach, the NCUSIF would treat FCUs and FISCUs in the same manner. Currently, states, as the prudential regulator of FISCUs, examine every one of their charters for both compliance and safety and soundness. The cost of this examination program is borne by FISCUs in the form of the operating fees they pay to the state. Those examinations are then provided to the NCUA in its capacity as administrator of the NCUSIF. Those state exams are then reviewed for share insurance purposes. In addition to reviewing those state examinations, the NCUA, on behalf of the NCUSIF, examines some FISCUs in conjunction with the states. However, the FISCU examinations conducted by NCUA for the benefit of the NCUSIF is minimized by the NCUSIF's reliance on state work.[62]

The NCUSIF should manage its FCUs in the same manner as it does its FISCUs. NCUA should examine all FCUs for compliance and safety and soundness in its capacity as chartering entity. Those exams should be used for NCUSIF purposes. To the extent additional supervision is required, then those additional costs should be borne by the NCUSIF. However, non-NCUSIF sources of funding should support a robust chartering safety and soundness examination program. As previously noted, this approach is consistent with NCUSIF treatment of FISCUs, consistent with the OCC's supervision of its national charters, and consistent with the FRB's supervision of its member banks.

[62] In fact, while NCUA relies on states for a majority of contacts and examinations in FISCUs, state regulators believe the agency can further increase reliance on states, reducing NCUA presence in FISCUs from current levels back to historic levels of 10-12% of FISCUs annually.

2) Rather than reduce the overhead transfer by the amount of the imputed value of state examination work, the NCUA should refund that money to federally insured state chartered credit unions

Requiring FCUs to bear the cost of safety and soundness supervision by their chartering authority is the most equitable manner of managing the NCUSIF and the OTR. Should NCUA insist on retaining the current OTR methodology, NCUA should change its treatment of the "SSA Imputed Value."

To the agency's credit, NCUA began in 2003, as advocated by NASCUS, to recognize the work done by state regulators supervising FISCUs for safety and soundness.[63] NCUA reduces the OTR by this "SSA Imputed Value." The NCUSIF saves millions of dollars a year because its safety and soundness work is done by the FISCUs' prudential regulators: the states. In November, 2015, NCUA estimated the benefit of the "SSA Imputed Value" to the NCUSIF of the work done by state regulators in FISCUs to be $40.6 million.[64] Recognizing that the work of the state regulators reduces the NCUSIF's costs is the right thing to do. However, while the NCUSIF might save money, state chartered credit unions are funding those state regulatory activities. NCUA's treatment of the "SSA Imputed Value" in its formula does little to represent true costs savings to the FISCUs that pay for it.

In order to recognize the true benefit of the "SSA Imputed Value" and the expenditures of state credit unions that generate it, NCUA should return that value directly to FISCUs.

Each year after calculating the "SSA Imputed Value," NCUA should return that amount, $40.6 million in 2015, back to FISCUs in the form of a rebate. The rebate can be distributed either on an equal basis or a pro rata basis to each FISCU. In 2015, NCUA reported 2,257 FISCUs as the fourth quarter.[65] Returning the "SSA Imputed Value" would have resulted in a rebate to each FISCU of approximately $17,988.48 on an equal basis, or on an insured-share proportional basis of approximately $8.79/insured share for each FISCU.

Of course, returning the imputed value of SSA work to FISCUs would necessitate a restructuring of NCUA's methodology. We think it is worthy of exploration, and would provide an opportunity to address other shortcomings in the current methodology we have identified.

NCUA has the authority to return to FISCUs the value of the state work those FISCUs have funded. Section 1782 of the FCUA specifically authorizes NCUA to distribute funds from the NCUSIF back to credit unions.[66] While the FCUA places limits on NCUA's ability to pay distributions from the funds, these limits apply to the statutory mandate to pay distributions if the funds in the NCUSIF exceed the established operating level. Our proposal here is not a dividend distribution subject to those provisions, rather it is in effect an operating expense to the NCUSIF,

[63] Overhead Transfer Rate, NCUA Board Action Memorandum (November 14, 2003) page 2.
[64] Overhead Transfer Rate Methodology, NCUA Board Action Memorandum (November 19, 2005) page 10. Available at https://www.ncua.gov/About/Documents/Agenda%20Items/AG20151119Item5a.pdf.
[65] Credit Union Data Summary 2015 Q4, National Credit Union Administration, available at https://www.ncua.gov/analysis/Pages/call-report-data/Reports/PACA-Facts/PACA-Facts-2015-12.pdf.
[66] 12 USC 1782(c)(3).

offsetting the cost of work performed by states, funded by FISCUs, and essential to the administration of the NCUSIF.

3) **Rather than reduce the overhead transfer by the amount of the imputed value of state examination work, the NCUA should pay out those funds for the benefit of the state agencies.**

Another option for NCUA is to treat the "SSA Imputed Value" as an expenditure from the fund in the same manner it would for a contract for services. In this case, the NCUA would dedicate an amount equal to the "SSA Imputed Value" for the benefit of the state agencies. Dedicating the amount for the benefit of the state agencies could take the form of increased training and technical assistance for the states, or transfer of the amount to a third party to manage on behalf of all of the states. This approach accomplishes several laudable goals.

First, it would result in a simplification of the OTR Methodology, lending greater transparency for stakeholders. This accomplishes one of the recommendations from NCUA's outside reviews of the methodology. Next, returning the value to state regulators provides more direct benefit to the state system. It is the state credit union system and state regulators that produce the work from which the imputed value arises. By recognizing this the NCUSIF can provide even more resources for states to use to continue to improve their supervisory capabilities. This in turn produces more value for the NCUSIF and enhances protection of the share insurance fund.

Some might be tempted to assert that state agencies, and hence their FISCUs, already "unfairly" benefit from NCUSIF funding in terms of training, hardware, and software. These same parties might also suggest that the NCUSIF may not always rely on specific state agencies based on unforeseen circumstance, for example state budget cuts that impede the ability of the state to conduct full scope examinations of its FISCUs. These assertions are misguided.

To the point regarding NCUSIF-provided training, software, and hardware, we note that the NCUSIF is also providing all of that, ***and more***, to the FCU examiners. In addition, not all states utilize NCUSIF provided software or hardware. In addition, virtually every state expends its own funds to provide its examiners training above and beyond what is provided by the NCUSIF.[67] All of that state-funded training, and state-funded software and hardware, benefit the NCUSIF, at no cost to the fund. Therefore, while NCUA allocates any expenses of its examiners related to the NCUSIF, the states are spending their own funds to provide benefits to the NCUSIF.

With respect to the hypothetical where the NCUSIF must provide primary examination coverage to a specific state's FISCUs for some reason, we note that this is an extremely rare occurrence. But more importantly, we reiterate that the NCUSIF is absorbing the entire safety and soundness expense for every single FCU everywhere. There is simply no equating a rare, isolated

[67] For example, in 2016, states will providing state funded training to examiners provided by NASCUS in areas of information and cyber security, BSA, commercial lending, among others. As another example, NCUA in 2016 chose to cancel one of its two annual meetings with state regulators as a cost cutting measure while continuing to fund its nationwide meeting of NCUA examiners. In response, the states, at their own expense, held a national meeting of their own to work on important safety and soundness and other supervisory issues. The NCUSIF ultimately benefits from that.

occurrence on the FISCU side with the day in, day out, occurrence for FCU safety and soundness supervision.

4) **The NCUA should eschew a formal overhead transfer calculation and establish the overhead transfer rate at 50% of its budget**

Once again, we concede that attempting to develop a methodology that tries to calculate the costs of administering the insurance fund without internally distinguishing the safety and soundness obligations of the chartering responsibilities from the safety and soundness responsibilities of administering the NCUSIF is a difficult task. Consequently, there might be merit in returning to a simple OTR of 50 percent of NCUA's annual operating budget. This would be consistent with the OTR for 30 of its 45 years.

The advantage of this approach is it balances simplicity with an acknowledgement that a restructuring of the OTR to truly reflect NCUA's Title I prudential supervisory responsibilities could possibly represent a steep rise in non-NCUSIF funding. Further, by tying the NCUSIF and non-NCUSIF expenses allocations to parity, NCUA can help ensure that some efficiencies of examination flow to the NCUSIF, contrary to the current approach which reverses the flow of efficiencies. Under this approach, NCUA could repurpose its methodology from calculating the OTR to tracking and managing NCUSIF examination hours as an efficiency metric.

With respect to the GAO studies that have instructed NCUA to hone its method of allocating costs between its Title I and Title II roles, we note that GAO's concerns were with regard to NCUA overcharging the NCUSIF. These reports were issued in the context of steady increases of the OTR from 50 percent to 60 percent and above.

Conclusion

One might assert (as NCUA does) that given NCUA's dual role, allocating the entire cost of FCU safety and soundness supervision to one centralized function (in this case the administration of the NCUSIF) is the most efficient means of organizing and operating the agency. Generally speaking, this might be true, however that is neither the question presented nor the point. Congress chose a specific structure for banking and credit union supervision, and that structure requires federal chartering authorities to supervise their charters for safe and sound operation while creating a redundant function in a deposit insurer to evaluate the safety and soundness of its insured institutions to mitigate risk to the deposit insurance fund.

NCUA's OTR Methodology is severely flawed. We sincerely believe our recommendations could improve the process in an equitable, and statutorily sound manner. As it now stands, NCUA's methodology is arbitrary, capricious, and inequitable to FISCUs.

We thank NCUA for the opportunity to provide formal comment on the methodology used to determine the Overhead Transfer Rate. As evidenced in this letter, we remain deeply concerned that the current allocation of NCUA's operating expenses is inequitable to the state credit union system and incompatible with the wording, and spirit, of the FCUA. However, we are confident that NCUA will careful consider these comments, and modify the methodology in a manner that is both fair and consistent with the construction of its statute.

We would be pleased to discuss these comments, in detail at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Lucy Ito
President & CEO

cc: SSAs
NCUA Chairman Matz
NCUA board member Metsger
NCUA board member McWatters

Legal Analysis Of The Administrative Procedure Used By The National Credit Union Administration To Adopt The Overhead Transfer Rate

Report to the

National Association of State Credit Union Supervisors

Schwartz & Ballen LLP
1990 M Street N.W.
Washington D.C. 20036

June 17, 2015

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Since 1971, the National Credit Union Administration ("NCUA" or "NCUA Board") has used the resources of the National Credit Union Share Insurance Fund ("NCUSIF") to cover the NCUA's annual "insurance-related" expenses. The percentage of annual expenses the NCUA Board uses to determine the amount it will take from the NCUSIF to cover the NCUA's annual expenses is referred to as the Overhead Transfer Rate (the "OTR"). The OTR percentage and the resulting dollar amount of NCUA total expenses covered by funds from the NCUSIF have increased significantly over time.

Primarily as a result of a change in OTR calculation methodology adopted by the NCUA Board for the 2014 OTR, the amount of NCUA expenses allocated to federally insured state-chartered credit unions ("FISCUs") through the OTR increased 40.1% from $67.0 million in 2013 to $93.9 million (budgeted) for 2015. This significant increase has reduced the likelihood that FISCUs and federal credit unions ("FCUs") (referred to collectively as "federally insured credit unions") will receive a rebate from the NCUSIF. Although increases in the OTR for 2014 and 2015 also increased the amount of NCUA expenses allocated to FCUs through the NCUSIF, such increases in the OTR directly and materially benefitted FCUs by reducing the amount the NCUA assessed FCUs for NCUA expenses (the "FCU Operating Fees"). By shifting a portion of FCUs' share of NCUA expenses to the NCUSIF, the OTR reduces out-of-pocket expenses incurred by FCUs. The resulting reduction in FCU Operating Fees provides a singular advantage to FCUs and adversely affects the competitive position of FISCUs relative to FCUs.

The NCUA Board has never published a proposed OTR in the *Federal Register* for public comment, nor has it ever requested in the *Federal Register* public comment on its methodology for calculating the OTR or any change to its methodology. The NCUA Board also has never provided a reasoned, comprehensive explanation of its OTR methodology, including how the activities it defines for this purpose as "insurance-related" are actually related to insurance, why it has changed its position over time as to what constitutes "insurance-related activities," why it chooses to makes an adjustment to the OTR rather than make a direct payment from the NCUSIF to the state supervisory authorities for their insurance-related supervision of FISCUs, nor has it provided an adequate explanation of the methodology it uses to determine this adjustment. In addition, we are not aware of any independent third party determination that the NCUA Board's OTR methodology complies with the Federal Credit Union Act ("FCUA") or other applicable law.

Our analysis concludes that the NCUA Board's adoption of the OTR constitutes a rule subject to the Administrative Procedure Act ("APA") notice and comment requirements. Based on applicable case law, including cases involving the NCUA Board, we do not believe that any of the exceptions provided in the APA to its notice and comment requirements apply to the OTR. Moreover, given its impact on federally insured credit unions generally and the adverse effect on the competitive position of FISCUs relative to FCUs, we believe the NCUA Board's adoption of the OTR should be deemed a major rule for purposes of the APA, subject to the additional requirements that the NCUA Board provide: (i) a statement of purpose providing the underlying reason for the rule; (ii) monetized or quantified costs and benefits or a qualitative discussion of them; and (iii) a discussion of the alternatives.

The fact that other federal banking agencies, the Office of the Comptroller of the Currency ("OCC"), Federal Deposit Insurance Corporation ("FDIC"), and Federal Reserve Board, follow the APA notice and comment process for the methodology they employ in determining their assessments and fees and/or for the actual assessments and fees strongly supports the conclusion that the NCUA Board's adoption of the OTR constitutes a rule subject to the APA notice and comment requirements. Finally, the GAO has recognized there are concerns with the procedures utilized by the NCUA Board to determine the OTR.

For the foregoing reasons, we believe the process the NCUA Board uses to implement the OTR violates the APA.[1] As courts have recognized:

> Voiding the present regulations on what at first blush appears to be a technicality is not as pointless as it may seem. We believe that the 30-day notice rule serves an important interest, the right of the people to present their views to government agencies which increasingly permeate their lives. The interchange of ideas between the government and its citizenry provides a broader base for intelligent decision-making and promotes greater responsiveness to the needs of the people, especially in cases such as this where Congress has only roughed in its program.

Anderson v. Butz, 428 F. Supp. 245, 251 (E.D.Cal. 1975) (quoting *Kelly v. U.S. Dep't. of the Interior*, 339 F. Supp. 1095, 1102 (E.D.Cal. 1972)).

[1] This Report does not address, and accordingly we express no opinion on, whether the NCUA Board possesses statutory authority to implement the OTR in the manner described in Section I.

I. HISTORY OF THE OTR

The NCUA, an independent federal agency established by the FCUA, charters FCUs and supervises both FISCUs and FCUs insured by the NCUSIF. The NCUA Board administers the NCUSIF, which was created in 1970 as a revolving fund in the United States Treasury to insure the accounts of FCUs and FISCUs.[2] The FCUA provides that the NCUA's expenses incurred in carrying out the examination and supervision of FCUs may be covered by operating fees assessed on FCUs.[3] The FCUA also provides that the NCUA Board may requisition funds from the NCUSIF to cover certain expenses.[4]

In 1972, the U.S. General Accounting Office[5] recommended that "insurance-related" and regulatory related costs be allocated between the NCUA and NCUSIF. The GAO observed that, during 1971 and 1972, the NCUA Board tried several different methods in attempts to develop an equitable method to allocate costs to the NCUSIF. The GAO, however, was unable to determine if the operating expenses presented on the NCUSIF's statement of income and expenses for that period were fairly stated because different methods were used and the GAO was unable to verify the basis used to make certain allocations.[6]

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[2] 12 U.S.C. § 1783.
[3] 12 U.S.C. § 1755.
[4] *See*, *e.g.*, 12 U.S.C. 1783(a). As noted in the Executive Summary, this Report does not address and accordingly we express no opinion on whether the NCUA Board possesses statutory authority to implement the OTR as described in this Section.
[5] Now known as the U.S. Government Accountability Office ("GAO").
[6] Comptroller General of the United States Report 74-0204, *Examination Of Financial Statements Of The National Credit Union Administration For The Periods Ended June 30, 1971 and 1972 Limited By Restriction On Access To Credit Union Examination Records*, pp. 14-15 (Sept. 1973).

In the following years until 1986, various cost allocation methodologies were implemented by the NCUA Board, including direct charges to the NCUSIF for insurance expenses (*e.g.*, cost of closing institutions and liquidation and merger costs), the cost of NCUSIF's full-time employees and the cost of the time NCUA's employees spent on NCUSIF examination and supervision activities.[7]

From 1986 through 1994, the NCUA's Office of Examination and Insurance conducted annual surveys of NCUA examiners to determine how much time examiners spent on insurance-related and non-insurance-related matters. The relative proportion of time spent by examiners on insurance–related matters was the principal factor that determined the OTR. During this ten year period, the survey results on the percent of "insurance-related" time spent by NCUA examiners varied between 50.1% and 60.4% of their total hours worked. Notwithstanding this range, the NCUA maintained the budgeted OTR at 50% of the NCUA's annual budget for the years 1986 through 1994.[8]

Based on a staff study conducted in 1994, the NCUA Board approved a 50% budgeted OTR for the three year period 1995-1997, and committed to re-evaluate the OTR in 1997. An in-depth study of examination time conducted in 1997 concluded that examiners spend approximately 50% of their time on insurance-related functions. As a result, in 1997, the NCUA Board approved a 50% budgeted OTR for the period 1998-2000.

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[7] In October 1985, the NCUA Board determined to eliminate the direct NCUSIF employee expense from the calculation of the OTR.

[8] Starting in 1989, the NCUA tapped the NCUSIF for certain of its expenses by means other than through the OTR. These included expenses incurred in connection with operating the Asset Liquidation Management Center and costs associated with training state examiners. These additional expenditures were not included in the NCUA's calculation of the budgeted OTR. If these expenses, for example, had been added to the OTR in 1989 (approximately $2 million), the OTR for that year would have increased to 53.6%. The OTR rates presented below do not include recoveries of NCUA expenses by means other than the OTR and FCU Operating Fees.

In 2000, the scope and methodology of the examiner survey was revised to include principal examiners, regional staff and central office staff. These revisions resulted in a dramatic increase in the budgeted OTR from 50% to 66.7% of the NCUA's annual budget for 2001 and 62% of the NCUA's annual budget for 2002 and 2003. During this 2000-2003 time period, the NCUA's annual budget increased 8.2% (from $135.0 million to $146.1 million) and its actual expenses increased 5% (from $127.6 million to $134.1 million). Importantly, however, the NCUA's expenses paid from the NCUSIF through the OTR increased 30.4% (from $63.8 million to $83.2 million) as a result of the increase in the OTR. In contrast, during the 1995-2000 time period during which the budgeted OTR remained constant at 50%, the percentage increase in NCUA expenses covered by the NCUSIF through the OTR (44.3%) corresponded to the percentage increases in the NCUA's annual budget (45.6%) and actual expenses (44.5%) during this time period.

In November 2003, the NCUA Board again revised the methodology for calculating and assessing the OTR. Key components of this new OTR calculation methodology included the results of the annual Examination Time Survey performed by a randomly selected group of principal examiners, NCUA's resource workload budget, NCUA's financial budget, the distribution of insured assets between FCUs and FISCUs, and an estimate of the "insurance-related" work conducted by state regulators.

Using this methodology, the OTR gradually declined between 2004 and 2008 as follows:

BUDGETED OTR AS A PERCENT OF NCUA ANNUAL BUDGET

YEAR	OTR
2004	59.8%
2005	57.0%
2006	57.0%
2007	53.3%
2008	52.0%

Attributed in part to increased NCUSIF-related activities due to macroeconomic developments, the budgeted OTR increased modestly between 2009 and 2013 as follows:

BUDGETED OTR AS A PERCENT OF NCUA ANNUAL BUDGET

YEAR	OTR
2009	53.8%
2010	57.2%
2011	58.9%
2012	59.3%
2013	59.1%

For the 2014 OTR, the NCUA Board adopted new mapping of NCUA regulations based on the extent to which, in the NCUA Board's view, each statute and regulation administered by the NCUA is designed to protect the NCUSIF and is therefore "insurance-related." Previously, for purposes of the Examination Time Survey, examiner activities were classified into two categories – "insurance-related" (*i.e.*, related to NCUA Board's role as an insurer of federally insured credit unions) and "regulatory-related" (*i.e.*, related to NCUA's role as a regulator and charterer of credit unions). For the 2014 OTR, "insurance-related" was separated into two categories: (1) "Insurance Related Examination" and (2) "Insurance Regulatory Related Examination." The former "regulatory-related" category was re-defined as the third category, "Consumer Regulatory Related Examination." Of the 252 rules and regulations identified by the NCUA as examination related, approximately 161 (64%) are categorized as "Insurance Regulatory Related Examination" and presumably included in the OTR. Approximately 91 or (36%) are categorized as "Consumer Regulatory Related Examination" and presumably excluded from the OTR. Based on this new mapping, the NCUA Board now appears to consider virtually all activities related to safety and soundness regulations to be "insurance-related" and therefore included in the determination of the OTR. The only regulatory activities that appear not to be included in the OTR are generally those that relate to consumer regulations.[9] Based on this new mapping, NCUA "insurance-related" examiner time increased from 67% for purposes of determining the 2013 OTR to 88% for the calculation of the 2014 OTR, with a resulting increase in the budgeted OTR from 59.1% in 2013 to 69.2% of NCUA budgeted total expenses in 2014,[10] a 17.1% year-over-year increase in the budgeted OTR.

As a consequence of this increase in the 2014 budgeted OTR, the budgeted contribution of FISCUs through the 2014 OTR to the NCUA 2014 Operating Budget increased to $85.6 million, which represents an $18.6 million (27.8%) increase over their 2013 contribution of $67.0 million.[11] The budgeted contribution of FCUs through the 2014 OTR to the NCUA 2014 Operating Budget increased to $100.1 million compared to their 2013 contribution of $79.0 million, which represents a $21.1 million increase (26.7%), which at first

[9] These statutes and regulations include: Equal Credit Opportunity Act (Regulation B); Bank Secrecy Act; Home Mortgage Disclosure Act (Regulation C); Expedited Funds Availability Act (Regulation CC); Children's Online Privacy Protection Act; Reserve Requirements (Regulation D); Electronic Fund Transfer Act (Regulation E); Fair and Accurate Credit Transactions Act; Fair Credit Reporting Act (Part 717); Fair Debt Collection Practices Act; Flood Disaster Protection Act; Fair Housing Act; Gramm-Leach-Bliley Act; Home Ownership and Equity Protection Act; Home Owner's Protection Act; Regulation M (Consumer Leasing); Office of Foreign Assets Control requirements; Privacy of Consumer Financial Information; Right to Financial Privacy Act; Service Members Civil Relief Act; Real Estate Settlement Procedures Act (Regulation X); Truth in Lending Act (Regulation Z); and Credit Practices (Part 706); and Truth in Savings Act (Part 707).

[10] This Report uses budgeted percentages and budgeted amounts for 2014 because the NCUA has not as of the date of this Report issued operating and financial results for 2014.

[11] The NCUA total budget for 2014 was $ 268.3 million, which represented a $26.5 million (11%), increase over its 2013 actual expenses of $241.8 million.

glance appears comparable to the percentage increase experienced by FISCUs. However, the increase of the OTR had a major impact on reducing FCU Operating Fees, which represent actual out-of-pocket expenditures for FCUs. By increasing the OTR, the NCUA Board was able to shift a substantial portion of NCUA expenses to the NCUSIF, thereby enabling it to reduce FCU Operating Fees for 2014. As a result, FCU Operating Fees in 2014 were budgeted to be $82.6 million, versus $93.1 million in 2013, a decrease of $10.5 million, or an 11.3% reduction compared to 2013, despite a $26.5 million (11%) increase in the NCUA Operating Budget for 2014.

The 2015 budgeted OTR not only continued this trend but, as applied, resulted in an even larger reduction in FCU Operating Fees than in 2014. Continuing to utilize this same mapping, NCUA "insurance-related" examiner time for purposes of determining the 2015 budgeted OTR was reported as 87.8%. The budgeted OTR for 2015 increased to 71.8% of NCUA budgeted total expenses. This represents a 21.5% increase in the 2015 budgeted OTR from 2013.

The budgeted contribution of FISCUs through the 2015 OTR to the NCUA 2015 Operating Budget increased to $93.9 million, which represents a $26.9 million (40.1%) increase over their 2013 contribution of $67.0 million.[12] The budgeted contribution of FCUs through the 2015 OTR to the NCUA 2015 budget increased to $106.8 million compared to their 2013 contribution of $79.0 million, which represents a $27.8 million (35.1%) increase.

As in 2014, the increase in the budgeted OTR will have a significant impact in reducing FCU Operating Fees in 2015. FCU Operating Fees in 2015 were budgeted to be $78.8

[12] The NCUA total budget for 2015 was $279.5 million, which represented a $37.7 million (15.5%) increase over its 2013 actual expenses of $241.8 million.

million, a $3.8 million (4.8%) decrease from budgeted FCU Operating Fees for 2014. More telling is the comparison of FCU Operating Fees between 2013, the last year before the new mapping of NCUA regulations discussed above, and 2015. FCU Operating Fees in 2015 were budgeted to be $78.8 million, versus $93.1 million in 2013, a decrease of $14.3 million, or an 18.1% reduction compared to 2013, despite a $37.7 million (15.6%) increase in the NCUA expenses from 2013 to those expected in 2015.

The increase in the 2014 budgeted OTR and 2015 budgeted OTR resulting in large part from this new mapping of NCUA regulations discussed above, as compared to the budgeted OTR for 2013, the last year before this new mapping, is as follows:

BUDGETED OTR AS A PERCENT OF NCUA ANNUAL BUDGET

YEAR	**OTR**
2013	59.1%
2014	69.2%
2015	71.8%

As a result of the NCUA Board's increases in the OTR discussed in this Section, FCUs have enjoyed a significant reduction in the FCU Operating Fees they otherwise would have been required to pay directly to the NCUA.

The following chart summarizes the impact of the OTR on the amount of NCUA total expenses incurred by FISCUs and FCUs for the period 2009-2015.

IMPACT OF NCUA OTR

($ in millions)

Year	NCUA Expenses[13]	NCUA Expenses Allocated to NCUSIF[14]	Budgeted OTR[15]	Actual OTR[16]	FISCUs share of NCUA Expenses Allocated to NCUSIF[17]	FCUs share of NCUA Expenses Allocated to NCUSIF[18]	FCU Operating Fees[19]
2009	$167.7	$ 90.2	53.8%	53.8%	$40.9	$49.3	$81.7
2010	$200.9	$113.6	57.2%	56.5%	$51.6	$62.0	$86.8
2011	$216.1	$130.0	58.9%	60.2%	$59.3	$70.7	$86.2
2012	$228.0	$137.5	59.3%	60.3%	$52.7	$74.8	$88.8
2013	$241.8	$146.0	59.1%	60.4%	$67.0	$79.0	$93.1
2014[20]	$268.3	$185.7	69.2%	--	$85.6	$100.1	$82.6
2015[21]	$279.5	$200.7	71.8%	--	$93.9	$106.8	$78.8

[13] Source: NCUA Annual Report, except for 2014 and 2015.
[14] The allocation to NCUSIF is 100% of the expenses of the Office of National Examinations and Supervision (Office of Corporate Credit Unions) to the extent that they exceed the actual operating fees paid by federal corporate credit unions (for the years where applicable), plus the OTR applied to all other expenses. Source: NCUA Annual Report, except for 2014 and 2015.
[15] As approved by NCUA Board for the calendar year.
[16] The Actual OTR is calculated by dividing the NCUA Expenses Allocated to NCUSIF column by the NCUA Expenses column. The Actual OTR can differ from the Budgeted OTR column because the actual NCUA Expenses and actual NCUA Expenses Allocated to NCUSIF for a given year may differ from the budgeted NCUA Expenses and budgeted NCUA Expenses Allocated to NCUSIF for that year. In addition, any recovery of NCUA expenses from the NCUSIF other than through the OTR are included in the Actual OTR calculation.
[17] Based on FISCUs share of total NCUSIF insured shares, as reported by NCUA Board for the calendar year.
[18] Based on FCUs share of total NCUSIF insured shares, as reported by NCUA Board for the calendar year.
[19] Source: NCUA Annual Report, except for 2014 and 2015.
[20] Source: NCUA Board estimates for 2014 as reported in Board Action Memorandum, dated November 20, 2013, from Office of Examination and Insurance to NCUA Board, Re: Overhead Transfer Rate 2014.
[21] Source: NCUA Board estimates for 2015 as reported in Board Action Memorandum, dated November 20, 2014, from Office of Examination and Insurance to NCUA Board, Re: Overhead Transfer Rate 2015.

II. ANALYSIS OF THE ADMINISTRATIVE PROCEDURE USED BY THE NCUA TO IMPLEMENT THE OTR

A. *NCUA BOARD'S IMPLEMENTATION PROCEDURE*

The NCUA Board in the past has held annual public briefings and forums on its Operating Budget, of which the OTR is a significant component. The last public briefing and forum was held by the NCUA Board in 2008. The NCUA Board has also received comment on the OTR outside of these public briefings and forums.[22] However, the NCUA Board has never formally requested comment by publishing in the *Federal Register* a proposed OTR, a proposed methodology for calculating the OTR or proposed changes to its methodology for calculating the OTR.

The NCUA Board also in our view has never provided a reasoned, comprehensive explanation of its OTR methodology, including how the activities it defines for this purpose as "insurance-related" are actually related to insurance, and why it has changed its position over time as to what constitutes "insurance-related activities." Since at least 2008, the NCUA Board has released an annual Board Action Memorandum prepared by the Office of Examination and Insurance which prescribes the Office of Examination and Insurance's recommendation for the OTR for the following year. This 2-3 page memorandum (with an attachment that contains only tables without textual explanation) provides only a summary description of the methodology used to calculate the OTR, including during years in which that methodology changed. For example, in its November 20, 2013 memorandum recommending the OTR for 2014, which as discussed in Section I increased materially based on a revised OTR methodology, the Office of

[22] As indicated below, the NCUA staff has stated that one of the reasons for its consideration of the OTR for 2012 was in part in response to industry comment, but did not mention that it considered the need for formal APA-compliant notice and comment.

Examination and Insurance provided only the following two paragraph explanation of the change to the OTR methodology:

> In 2012, the Office of Examination and Insurance (E&I) clarified the application of the insurance-related and non-insurance related definitions in the ETS [Examiner Time Survey] in response to industry and examiner comments. This clarification involved how examiners record on the ETS time they spend examining for compliance with various regulations. Specifically, the NCUA rules and regulations were individually mapped to the proper ETS category based on the extent to which a regulation was designed to protect the NCUSIF (a new sub-category of insurance related labeled "insurance-regulatory") or to govern commerce and/or provide consumer protection (labeled "non-insurance or consumer regulatory").
>
> This breakdown and mapping of regulations is consistent with the existing overall definitions of insurance-related and non-insurance related. The primary definitions have not changed; the regulations have merely been explicitly mapped based on the overarching definitions. While examiners continue to use their judgment as to what exam procedures to perform during an examination or supervision contact based on the risks and product-service mix of credit union, this clarification creates more consistency as to where examiners record the time on the ETS.[23]

Notwithstanding this statement of the Office of Examination and Insurance that this mapping "is consistent with" the previously utilized definitions of insurance-related and non-insurance related, it appears that certain NCUA regulatory activity that was previously considered "regulatory-related" and therefore not included in the OTR was recast as a result of this mapping as "Insurance Regulatory Related Examination" for purposes of, and included in, the 2014 OTR. Although the Office of Examination and Insurance then references a 2013 PricewaterhouseCoopers review of the mapping of NCUA regulations to the categories on the ETS (discussed further below) which was attached to its memorandum, nowhere in that

[23] Office of Examination and Insurance Memorandum to NCUA Board, Overhead Transfer Rate 2014, p. 2 (November 20, 2013), available at http://www.ncua.gov/about/Documents/Agenda%20Items/AG20131121Item5a.pdf.

memorandum or in the attached PricewaterhouseCoopers review is an explanation provided as to why each particular regulation is considered "insurance-regulatory" or "non-insurance or consumer regulatory" for purposes of the OTR calculation.

The adjustment made by the NCUA Board to the OTR for the value to the NCUSIF of the insurance-related supervision provided by the state supervisory authorities and relied upon by the NCUA in managing the NCUSIF provides another example of the NCUA Board's failure to provide a reasoned, comprehensive explanation of its OTR methodology. For the 2015 OTR, this adjustment, referred to by the NCUA Board as the "Imputed SSA Value," was $41.56 million, approximately 14.9% of the 2015 NCUA budgeted expenses. Although the annual Board Action Memorandum prepared by the Office of Examination and Insurance includes a 4-step worksheet for the Imputed SSA Value calculation, no textual explanation is provided describing the methodology used for the Imputed SSA Value calculation nor are the sources for certain of the calculation inputs explained. Notwithstanding the significance of this Imputed SSA Value to the OTR calculation, the NCUA Board has never explained why it has determined to make this adjustment rather than, for example, pay the state supervisory authorities directly from the NCUSIF or use alternative methodologies to make this adjustment.[24]

In addition, we are not aware of any independent third party determination that the NCUA Board's OTR methodology complies with the FCUA or other applicable law. In a report

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[24] The NCUA Board has not explained, for purposes of the SSA Imputed Value: (i) why it uses the examination and supervision hours spent for FCUs by asset size and CAMEL rating and the NCUA Examination Time Survey, rather than the state supervisors' actual FISCUs "insurance-related" examination and supervision hours; (ii) why it assumes a 50-50 allocation for the insurance-related work in current FISCUs joint examinations; (iii) why it uses the larger, rather than the smaller or an average of, the exam hour calculations (current budgeted state exam insurance hours and projected FISCUs exam insurance hours based on the Examination Time Survey); (iv) the basis for the adjustment increase for Budgeted Supervision Hours; and (v) the NCUA staffing models and productivity levels used to translate additional workload hours to staff positions and the imputed cost of these positions.

issued January 20, 2011, PricewaterhouseCoopers evaluated the reasonableness and soundness of the methodology adopted by the NCUA Board in the calculation and administration of the OTR. But PricewaterhouseCoopers indicates in this report that it "does not express an opinion related to any issues that may be perceived with regards to NCUA's dual role as regulator and insurer, oversight or lack thereof of NCUA's budget or an interpretation of Congressional intent behind Title II of the Federal Credit Union Act of 1970 which established NCUSIF."[25] As discussed above, PricewaterhouseCoopers in 2013 analyzed the NCUA Board's proposed mapping of its rules and regulations resulting in the 2014 OTR. However, PricewaterhouseCoopers states in that report that its review "does not constitute an audit or evaluation of the administration and execution of the [Examination Time Survey], the overhead transfer rate (OTR) methodology or resulting OTR calculation."[26]

B. *THE ADMINISTRATIVE PROCEDURE ACT*

Under the APA, an agency such as the NCUA must follow APA-specified notice and comment requirements for its "rule making." "Rule making" is defined in the APA as an agency process for formulating, amending, or repealing a "rule."[27] "Rule," in turn, is defined as:

> [T]he whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of

[25] Overhead Transfer Rate Review For National Credit Union Administration, PricewaterhouseCoopers, p. 3 (January 20, 2011).
[26] National Credit Union Administration Analysis of Examination Time Survey (ETS) Modifications, PricewaterhouseCoopers, page 1 (October 2, 2013), available at http://www.ncua.gov/about/Documents/Agenda%20Items/AG20131121Item5b.pdf.
[27] 5 U.S.C. § 551(5).

valuations, costs, or accounting, or practices bearing on any of the foregoing.[28]

When an agency is engaged in APA "rule making," the agency must: (1) publish a general notice of proposed rule making in the *Federal Register* that includes "the terms or substance of the proposed rule or a description of the subjects and issues involved;" (2) give "interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments;" and (3) "[a]fter consideration of the relevant matter presented . . . incorporate in the rules adopted a concise general statement of their basis and purpose."[29]

Courts are charged with ensuring that agencies comply with the procedural requirements of the APA. *Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979).

The OTR, and the methodology used by the NCUA Board to calculate the OTR, is an NCUA Board statement of general applicability and future effect designed to implement and interpret the FCUA provisions addressing the OTR, as expressly contemplated by the APA definition of "rule." Also, because the OTR affects the NCUSIF coverage ratio as well as FCU Operating Fees, it is an "approval or prescription for the future of rates, financial structure, facilities, appliances, services or allowances, costs and/or accounting or practices bearing on any of the foregoing," as expressly contemplated by the APA's definition of "rule."

The OTR apportions to FISCUs through the NCUSIF assessment a significant percentage of NCUA total costs (33.6% or $93.9 million of NCUA budgeted costs for 2015). In addition, although FCUs also pay a significant percentage of NCUA costs through the OTR (38.2% or $106.8 million of NCUA budgeted costs for 2015), increases in the OTR have the

[28] 5 U.S.C. § 551(4).
[29] 5 U.S.C. §§ 553 (b), (c).

effect of substantially reducing FCU Operating Fees because of the shift of NCUA expenses from FCUs to the NCUSIF, which is funded by all federally insured credit unions. For example, FCU Operating Fees budgeted for 2015 dropped $14.3 million (18.1%) as compared to the 2013 FCU Operating Fees, notwithstanding a $37.7 million (15.6%) increase in the NCUA Operating Budget from 2013 to 2015. This was due to the increase in the budgeted OTR from 59.1% in 2013 to 71.8% in 2015, which resulted in large part from the change in the OTR calculation methodology for the 2014 and 2015 budgeted OTR discussed in Section I.

As a result, the competitive position of FISCUs relative to FCUs was adversely impacted by the change in OTR methodology for the 2014 and 2015 budgeted OTR and the resultant increase in the budgeted OTR for 2014 and 2015 relative to 2013. That is, during this two year time period, FISCUs have borne an increasing percentage of NCUA expenses, whereas FCUs enjoyed a substantial reduction of $10.5 million (11.3%) in their out-of-pocket FCU Operating Fees between 2013 and 2014 and an additional budgeted reduction of $3.8 million (4.8%) between 2014 and 2015, for a total budgeted reduction between 2013 and 2015 of $14.3 million (18.1%) from 2013 to 2015. Further, an increase in the OTR combined with the same or increased NCUA expenses decreases the likelihood and amount of any *pro rata* distribution to federally insured credit unions provided for in 12 U.S.C. § 1782(c)(3). Accordingly, barring the applicability of one of the APA exceptions discussed later in this Section, based upon the effect on FISCUs and FCUs, we believe the NCUA Board calculation of the OTR is a “rule” subject to APA notice and comment requirements.

Indeed, given its impact on federally insured credit unions generally and the adverse effect on the competitive position of FISCUs relative to FCUs, we believe the NCUA Board’s adoption of the OTR should be deemed a major rule for purposes of the APA.[30] In addition to the APA requirements discussed above, major rules should contain: (i) a statement of purpose providing the underlying reason for the rule; (ii) monetized or quantified costs and benefits or a qualitative discussion of them; and (iii) a discussion of the alternatives.[31]

The APA contains certain exceptions to its notice and comment requirements.[32] As a general matter, "[t]he legislative history of the [APA] demonstrates that Congress intended the exceptions in § 553(b)(B) to be narrow ones." *Nat'l Nutritional Foods Ass'n v. Kennedy*, 572 F.2d 377, 384 (2d Cir. 1978). "Congress expected, and the courts have held, that the various exceptions to the notice-and-comment provisions of section 553 will be narrowly construed and only reluctantly countenanced." *N.J. Dep't of Envtl. Prot. v. EPA*, 626 F.2d 1038, 1045 (D.C. Cir. 1980).

The first exception from the APA notice and comment requirements is for "rules of agency organization, procedure or practice."[33] The general approach that courts have followed in determining the applicability of this exception is whether the rule in question has a substantive impact of broad applicability. In *Minard Run Oil Company v. United States*, 670 F.3d 236 (3d Cir. 2011), the Third Circuit Court of Appeals rejected the government's contention that the Forest Service's new requirement that companies proposing to drill on federal land complete a forest-wide environmental impact statement was a rule of agency organization, procedure or

[30] Major rules are defined by the Congressional Review Act as rules that will likely result in: (i) an annual effect on the economy of $100 million or more; (ii) major increases in cost or prices for consumers, individual industries, federal, state or local government agencies, or geographic regions, or (iii) significant adverse effects on competition, employment, investment, productivity, or innovation, or on the ability of U.S.-based enterprises to compete with foreign-based enterprises in domestic and export markets. 5 U.S.C. § 804(2). The Office of Management and Budget's Office of Information and Regulatory Affairs is responsible for making major rule designations for independent regulatory agencies such as the NCUA. 5 U.S.C. § 804(2).
[31] *See*, United States General Accounting Office Report 14-714, *Federal Rulemaking* (Sept. 2014).
[32] 5 U.S.C. § 553(b).
[33] 5 U.S.C. § 553(b)(3)(A).

practice because the purpose and effect of this rule was to prevent new drilling by mineral rights owners during the course of the multi-year environmental impact statement. Additionally, the court also considered whether the rule in question would "have a substantial adverse impact on the challenging party." The court, citing *SBC, Inc. v. FCC*, 414 F.3d 486, 497-98 (3d Cir. 2005), explained that "rules of agency organization, procedure or practice" do not themselves shift the rights or interests of the parties, although they may change the way in which parties present themselves to the agency. The court concluded that, in contrast, rules that work substantive changes in prior regulations, or create new law, rights, or duties, are subject to the notice and comment requirements of the APA.

Similarly, in *Anderson*, the U.S. District Court for the Eastern District of California rejected the government's argument that an instruction of the Secretary of Agriculture that the calculation of household income for food stamp users was to include the amount of government rent subsidies paid directly to a low income housing tenant's landlord was not subject to APA notice and comment because it was a rule of agency organization, practice or procedure. The court explained that "a significant difference exists between interpretive rules and general statements of policy which affect only the internal operations or actions of an agency and those rules which affect the substantive rights of others outside of the agency. Requiring publication of notice of proposed rule making with invitation to comment makes little sense if only internal operations or management of the agency are involved since agency actions on these matters would have no direct effect upon the substantive rights of persons outside the agency." The court concluded that APA notice and comment was required for this rule change because substantive rights of persons outside the agency who are receiving rent subsidies are directly affected by the instruction because it raises the cost of their allocated food stamps. The

Secretary's instruction, according to the court, was therefore not a mere matter of agency management. The court cited several cases that have held that agency rulemaking is subject to APA notice and comment if it substantially affects the rights of persons subject to agency regulations, including *Pickus v. U.S. Board of Parole,* 507 F.2d 1107 (D.C. Cir. 1972); *Lewis-Mota v. Secretary of Labor*, 469 F.2d 478 (2d Cir. 1972); *Texaco, Inc. v. Federal Power Commission*, 412 F.2d 740 (3d Cir. 1969). The court explained why it is "important and proper that before an agency undertakes to promulgate rules affecting substantive rights of others outside the agency, there should be an opportunity afforded for an exchange between those whose rights are affected and the government." Quoting *Kelly*, the court stated:

> Voiding the present regulations on what at first blush appears to be a technicality is not as pointless as it may seem. We believe that the 30-day notice rule serves an important interest, the right of the people to present their views to government agencies which increasingly permeate their lives. The interchange of ideas between the government and its citizenry provides a broader base for intelligent decision-making and promotes greater responsiveness to the needs of the people, especially in cases such as this where Congress has only roughed in its program.

Anderson, 428 F. Supp. at 251 (quoting *Kelly*, 399 F.Supp. at 1102).

Given the widespread effect of the OTR on federally insured credit unions generally and FISCUs particularly, we do not believe that the NCUA could justify its failure to follow APA notice and comment procedures on the grounds that the OTR comes within the APA exception for a rule of "agency organization, procedure or practice" under 5 U.S.C. § 553(b)(3)(A).

The APA also provides that publication of notice and opportunity for comment are not required for "interpretative rules" or "general statements of policy."[34] As the courts often have analyzed these two exceptions in the same manner and sometimes use these exceptions interchangeably, we consider them together. The courts generally draw a distinction between "interpretive rules" or "general statements of policy" on the one hand for which no notice or comments is required under the APA, and "substantive rules" or "legislative rules" on the other hand for which APA notice and comment is required.

Substantive rules affect individual rights and are binding on the courts, whereas interpretive rules leave the agency free to exercise discretion**.** *Williams v. Van Buren*, 117 F. App'x 985, 986 (5th Cir. 2004) (*per curiam*). The critical feature of interpretive rules is that they are issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers; interpretive rules do not have the force and effect of law and are not accorded that weight in the adjudicatory process. *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199 (2015). An example of an interpretive rule would be where the agency intends merely to publish a policy guideline that is subject to attack when it is finally applied in future cases. *Pac. Gas & Elec. Co. v. FPC*, 506 F.2d 33, 39 (D.C. Cir. 1974); *see also, Doe v. Hampton*, 566 F.2d 265, 280-81 (D.C. Cir. 1977).

The D.C. Circuit Court of Appeals has described the distinction between legislative rules, interpretive rules and policy statements as follows:

> An agency action that purports to impose legally binding obligations or prohibitions on regulated parties -- and that would be the basis for an enforcement action for violations of those obligations or requirements -- is a legislative rule…(As to interpretive rules, an agency action that merely

[34] 5 U.S.C. § 553(b)(3)(A).

> interprets a prior statute or regulation, and does not itself purport to impose new obligations or prohibitions or requirements on regulated parties, is an interpretive rule.) An agency action that merely explains how the agency will enforce a statute or regulation—in other words, how it will exercise its broad enforcement discretion or permitting discretion under some extant statute or rule -- is a general statement of policy.

Nat'l Mining Ass'n v. EPA, 758 F.3d. 243, 251-52 (D.C. Cir. 2014).

In distinguishing between legislative rules and general statements of policy, the D.C. Circuit has long been guided by two important factors: "the actual legal effect (or lack thereof) of the agency action in question on regulated entities," and the "agency's characterization" of the agency action. *Nat'l Mining Ass'n*, 758 F.3d at 252. The first factor "focuses on the effects of the agency action" asking whether the agency has "(1) impose[d] any rights and obligations, or (2) genuinely [left] the agency and its decisionmakers free to exercise discretion." *Wilderness Soc'y v. Norton*, 434 F.3d 584, 595 (D.C. Cir. 2006) (quoting *CropLife Am. v. EPA*, 329 F.3d 876, 883 (D.C. Cir. 2003)). The second factor looks to the agency's expressed intentions: "(1) the [a]gency's own characterization of the action; (2) whether the action was published in the *Federal Register* or Code of Federal Regulations; and (3) whether the action has binding effects on private parties or the agency." *Wilderness Soc'y*, 434 F.3d at 595 (quoting *Molycorp v. EPA*, 197 F.3d 543, 545 (D.C. Cir. 1999)).

To determine whether a rule is a substantive or legislative rule rather than an interpretive rule, the D.C. Circuit applies a four-factor test that considers: (1) whether in the absence of the rule there would not be an adequate legislative basis for enforcement action or other agency action to confer benefits or ensure the performance of duties; (2) whether the agency has published the rule in the Code of Federal Regulations; (3) whether the agency has explicitly invoked its general legislative authority, and (4) whether the rule effectively amends a prior legislative rule. Generally, if any one of these prongs is satisfied, the rule is legislative rather than interpretive. *Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

Credit Union Nat'l Ass'n v. Nat'l Credit Union Admin., 573 F. Supp. 586 (D.D.C. 1983) is particularly instructive as to whether a court would view the OTR as an "interpretive rule" or "general statement of policy" exempt from APA notice and comment requirements. This case involved the NCUA Board's adoption of new payout priorities for involuntary liquidating FCUs under Subchapter II of the FCUA without APA notice or comment. NASCUS and the Credit Union National Association ("CUNA") challenged on the basis that the NCUA Board's adoption of new payout priorities constituted a rule which required the NCUA Board to comply with APA notice and comment requirements. The U.S. District Court for the District of Columbia determined the new payout priorities were substantive or legislative rules, rather than interpretative rules as contended by the NCUA Board, and therefore subject to APA notice and comment requirements. The court explained that the proper analysis for this purpose was articulated in *Wine Co. v. Snyder*, 194 F.2d 329, 331 (D.C. Cir. 1952):

> In applying the Gibson Wine test, however, "there is no 'reason to doubt the continuing vitality of the substantial impact test as . . . one of several criteria for evaluating claims of exemption from [the APA].' " *Cabais*, 690 F.2d at 237, quoting *Batterton*, 648 F.2d at 709 n.83.
>
> Under this analysis, it is inescapable that [the NCUA Board's rule in question] is a legislative rather than an interpretive rule, despite NCUA's own characterization. Such agency labels, although "entitled to a significant degree of credence," *Cabais*, 690 F.2d at 238 n.7; *British Caledonian*, 584 F.2d at 992, are not dispositive. Here, the [NCUA] Board clearly issued [the NCUA Board's rule in question] to implement its mandate to make payments as liquidating agent for closed federal credit unions pursuant to 12 U.S.C. § 1787(a)(2). The agency's "intent" -- a factor the Court must take into account -- is revealed by the rule's effect and not only by its characterization. *Chamber of Commerce of the United States v. OSHA*, 204 U.S. App. D.C. 192, 636 F.2d 464, 468 (D.C. Cir. 1980), quoting *Columbia Broadcasting System, Inc. v. United States*, 316 U.S. 407, 416, 86 L. Ed. 1563, 62 S. Ct.

> 1194 (1942). The Board stated that its intent was "to make . . . a change to the payout priority," in accordance with the GAO's recommendation. Although the statute itself is silent on the matter of payout priorities, the Board relied on its own authority to 'establish[]' priorities. Such legislative action by an agency cannot be disguised by the simple semantic maneuver of claiming it 'explains' or 'clarifies 12 U.S.C. §§ 1787(a)(2) and 1787(d). *See e.g.*, *Chamber of Commerce*, 204 U.S. App. D.C. 192, 636 F.2d 464; *American Bus Association v. United States*, 201 U.S. App. D.C. 66, 627 F.2d 525 (D.C. Cir. 1980). Defendant implicitly recognizes the true character of [the NCUA Board's rule in question] by describing the rule as giving 'operational meaning' to the statute. (Defendant's memorandum in support of its motion at p. 15.) The Board's decision to apply the new priority scheme prospectively only is a further indication that its effect is to create new law and not merely to interpret existing law.
>
> Because [the NCUA Board's rule in question] is not an 'interpretive rule,' it must be vacated for failure to comply with the APA's notice and comment requirements.

Credit Union Nat'l Ass'n, 573 F. Supp. at 591.

As with the NCUA Board's payout priorities for involuntary liquidating FCUs at issue in *Credit Union Nat'l Ass'n*, we believe that the NCUA Board's OTR similarly should be found to be a substantive rule subject to APA notice and comment. As with the NCUA Board's payout priorities for involuntary liquidating FCUs, the OTR creates new law by implementing the provisions of the FCUA addressing the OTR with substantial effect without further NCUA action on federally insured credit unions in general and FISCUs in particular. Applying the test developed by the D.C. Circuit confirms that the OTR is a substantive or legislative rule subject to the notice and comment requirements of the APA. In the absence of the OTR, there would not be an adequate legislative basis for the NCUA to shift its expenses to federally insured credit unions by requisitioning funds from the NCUSIF to cover expenses, nor has the NCUA published the OTR in the *Federal Register* or in the Code of Federal Regulations. Moreover, the NCUA has stated that it is relying on its authority under the FCU Act to establish the OTR.

Finally, by continuing to alter the methodology for computing the OTR, the NCUA has effectively amended its prior OTR rules.

The final exception to the APA notice and comment requirements is the so-called "good cause" exception. The APA provides that notice and comment requirements do not apply "when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[35]

There is currently a conflict among the Circuits regarding the appropriate standard of review for an agency's assertion of good cause under 5 U.S.C. § 553(b)(3)(B). The Eighth Circuit defers to the agency's determination and reviews only whether the agency's determination of good cause complies with Congressional intent. *United States v. Gavrilovic*, 551 F.2d 1099 (8th Cir. 1977). This deferential standard appears similar to the approach taken by the Fifth and Eleventh Circuits, which each use an arbitrary and capricious standard. *United States v. Johnson*, 632 F.3d 912, 928 (5th Cir. 2011); *United States v. Dean*, 604 F.3d 1275, 1278 (11th Cir. 2010). The Fourth and Sixth Circuits; however, apply *de novo* review, which generally affords less deference to the determination of the agency in question. *United States v. Gould*, 568 F.3d 459, 469-70 (4th Cir. 2009); *United States v. Cain*, 583 F.3d 408, 420-21 (6th Cir. 2009).

Several Circuits have considered the Attorney General's finding that good cause existed to waive notice and comment for its regulations implementing the Sex Offender and Registration Notification Act. The Attorney General offered two rationales for waiving these

[35] 5 U.S.C. § 553(b)(3)(B).

requirements: (1) the need to eliminate "any possible uncertainty" about the applicability of the Act; and (2) concern that delay would endanger the public through the commission of additional sexual assaults and child sexual abuse or exploitation offenses by sex offenders that could have been prevented had the local authorities and communities been aware of the presence of the sexual predators, in addition to greater difficulty in apprehending perpetrators who have not been registered and tracked as provided in the Act.[36] Two Circuits, the Fourth and Eleventh, found good cause to exist to bypass notice and comment. *Gould*, 568 F.3d at 469-70 (interim rule necessary to provide "legal certainty about [the Act's] 'retroactive' application"); *Dean*, 604 F.3d at 1281 (public safety exception to notice and comment applied not only to true "emergency situations" but also to situations "where delay results in serious harm."). However, the Third, Fifth, Sixth, Eight and Ninth Circuits found that the Attorney General's stated reasons for finding good cause to bypass notice and comment were insufficient. *United States v. Reynolds*, 710 F.3d 498, 509 (3rd Cir. 2013); *Johnson*, 632 F.3d at 928; *Cain*, 583 F.3d at 421-24; *United States v. Brewer*, 2014 U.S. App. LEXIS 17454 (8th Cir. 2014); *United States v. Valverde*, 628 F.3d 1159, 1168 (9th Cir. 2010). For example, the Eighth Circuit determined that some uncertainty follows the enactment of any law that provides an agency with administrative responsibility, so that rationale if accepted by the court would justify an exception to notice and comment in all cases. The Eighth Circuit also found that the Attorney General's public safety rationale is nothing more than a rewording of the statutory purpose Congress provided in the text of the Act and delay in implementing a statute always will cause additional danger from the same harm the statute seeks to avoid. The Eighth Circuit then observed, although the risk of future harm may under some circumstances justify a finding of good cause, that risk must be more substantial than a mere possibility. Accordingly, the Eight Circuit determined that, even under an arbitrary and

[36] 72 *Fed. Reg.* 8894, 8896-97 (February 28, 2007).

capricious standard of review, there was an insufficient showing of good cause for bypassing the APA's requirement of notice and comment. *Brewer*, 2014 U.S. App. LEXIS at *5.

Based on the above judicial articulations of the good cause exception, the NCUA Board should not be able to rely upon this exception to justify its failure to provide for APA notice and comment for the OTR, regardless of the standard of review applied to the NCUA Board's assertion of good cause. If protection from sexual assaults and child sexual abuse or exploitation by sex offenders does not justify the good cause exception from APA notice and comment, it seems unlikely that any uncertainty or delay in applying the OTR would justify such an exception.

C. *Procedures of Other Federal Banking Agencies*

The procedures other federal banking agencies utilize to establish their fees and charges also is instructive of the APA procedural requirements for the OTR. The OCC establishes assessments and other fees for its examination and supervision of national banks and federal savings banks. The OCC follows an APA notice and comment process both for the methodology it uses for determining these assessments and fees, as well as for its actual assessments and fees.[37] The FDIC is less analogous to the NCUA than the OCC because the FDIC (unlike the NCUA and OCC) recovers all of its costs from insurance assessments, except for liquidation costs recovered from the estate of failed FDIC-insured banks. However, the FDIC utilizes an APA notice and comment process for its assessment methodology.[38] The

[37] *See,* 12 C.F.R. pt. 8, proposed for public comment at 76 *Fed. Reg.* 30557 (May 26, 2011); and 2014 OCC fees proposed for public comment at 79 *Fed. Reg.* 23297 (April 28, 2014).
[38] *See,* 12 C.F.R. pt. 327, proposed for public comment at 75 *Fed. Reg.* 66262 (October 27, 2010) (Notice of Proposed Rulemaking on Assessment Dividends, Assessment Rates and Designated Reserve Ratio). *See also,* Notices of Proposed Rulemaking on the Assessment System Applicable to Large Depository Institutions; 73 *Fed. Reg.* 15459 (March 24, 2008); 71 *Fed. Reg.* 28808 (May 18, 2006).

Federal Reserve Board, like the NCUA, has concurrent regulatory and other responsibilities and, for purposes of calculating Reserve Bank fees for priced services, allocates expenses between priced services and these other responsibilities. While the Federal Reserve Board does not solicit public comment on the fees for Federal Reserve Bank priced services, it does provide APA-compliant notice and comment on the methodology it uses to develop these fees.[39] In addition, as required under the Dodd-Frank Act, the Federal Reserve Board recently begun imposing assessments for bank holding companies and savings and loan holding companies with total consolidated assets of $50 billion or more and nonbank financial companies designated for Federal Reserve Board supervision by the Financial Stability Oversight Council equal to the total expenses the Federal Reserve Board estimates are necessary or appropriate to carry out its supervisory and regulatory responsibilities for these entities; and the Federal Reserve Board followed an APA-compliant notice and comment process for these new assessment fees.[40] The fact that these other federal banking agencies follow the APA notice and comment process for the methodology they employ in determining their assessments and fees and/or for the actual assessments and fees strongly supports the conclusion that the NCUA Board's adoption of the OTR constitutes a rule subject to the APA notice and comment requirements.

[39] *See e.g.*, 65 *Fed. Reg.* 82360 (December 28, 2000); 74 *Fed. Reg.* 15481 (April 6, 2009).

[40] 78 *Fed. Reg.* 23162 (April 18, 2013).

D. ***GAO REVIEW***

The GAO previously has recognized there are concerns with the procedures utilized by the NCUA Board to determine the OTR. After the NCUA Board abandoned its then long-standing policy of a 50% OTR and increased the budgeted OTR to 66.7% for 2001 and 62% for 2002 and 2003 as discussed in Section I, the GAO studied the methodology used by the NCUA Board for the 2001-2003 OTR. In explaining the importance of the OTR, the GAO stated that "[t]he sharp increase in the overhead transfer rate and its negative impact on NCUSIF's net income have raised questions about NCUA's process for determining the transfer rate."[41] The GAO noted in this study that the NCUA Board did not implement the GAO's recommendation in its 1991 report that the NCUA should establish separate supervision and insurance offices.[42] The GAO then concluded that "[a]s currently determined by the NCUA, the overhead transfer rate may not have accurately reflected the actual time spent by NCUA staff on insurance-related activities."[43] Following this 2003 GAO report, the NCUA Board revised its OTR methodology, which resulted in lower OTRs than during the 2001-2003 time period, until the NCUA Board again revised its methodology for the 2014 and 2015 OTR.

[41] United States General Accounting Office Report 04-91, *Credit Unions Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management*, p. 59 (Oct. 2003).
[42] *Id.*, at p. 61. *See also*, United States General Accounting Office Report 91-85, *Credit Union Reforms for Ensuring Future Soundness*, pp. 11-12, 186-192, 197 (July 1991).
[43] *Id.*, at pp. 81-82.

III. CONCLUSION

For the reasons discussed above, we believe that the NCUA Board's adoption of the OTR would be deemed to constitute a "rule" subject to APA notice and comment requirements. Because the NCUA Board has never followed this APA notice and comment process for the OTR, we believe the process utilized by the NCUA Board to implement the OTR violates the APA.